S. HRG. 101-697

SUPER IRA PROPOSAL

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 1682

SEPTEMBER 29, 1989

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

28-509 -. WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5361-34

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SUPER IRA PROPOSAL

FRIDAY, SEPTEMBER 29, 1989

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in Room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Also present: Senators Moynihan, Bradley, Pryor, Riegle, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Durenberger, and Symms.

[The press release announcing the hearing follows:]

[Press Release No. H-48, Sept. 27, 1989]

FINANCE COMMITTEE HEARING PLANNED ON BENTSEN SUPER IRA PROPOSAL, TREASURY SECRETARY BRADY TO TESTIFY AT HEARING

WASHINGTON, DC—Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, announced Wednesday that Treasury Secretary Nicholas Brady will be the leadoff witness for a Finance Committee hearing this Friday on the Bentsen Super IRA proposal.

The hearing will be at *10 a.m. on Friday, September 29, 1989* in Room SD-215 of the Dirksen Senate Office Building.

The Bentsen proposal—which has 34 Senate cosponsers—would expand and restore the Individual Retirement Account, which was curtailed by the 1986 Tax Reform Act.

"I'm glad that Secretary Brady will be testifying at this hearing, and we're looking forward to his comments on expanding and restoring IRAs," Bentsen said.

The Bentsen Super IRA proposal would make deductible IRAs available to all Americans. Everyone now eligible for fully deductible IRAs would continue to get the same tax treatment. Americans not currently eligible for deductible IRAs would be able to deduct against their income tax $1 for every $2 contributed to an IRA, up to a $2,000 contribution. Also, spouses who have no outside income would continue to be able to contribute an additional $250 to an IRA.

Penalty-free IRA withdrawals would be allowed for college education expenses or to help purchase a first home.

"We have lower savings, higher interest rates and less investment than any of our major trading partners. As a result, U.S. productivity growth—which is the key to future prosperity—has fallen to only half that of our trading partners. By increasing savings, the Super IRA will help get interest rates down in this country and help us be competitive with other nations," Bentsen said.

"This expanded and restored IRA will help us on our trade balance, and it will help Americans with the major purchases they will make in their lifetimes—buying that first home and paying for college," Bentsen said.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, SENATE FINANCE COMMITTEE

The CHAIRMAN. This hearing will come to order.

Mr. Secretary, we are very pleased to have you.

Mr. Secretary, I think it is time we bring the IRA out of retirement. I want to restore it and expand it, to help finance the two biggest investments most Americans make in their lives, and those are a first home and a college education, and I am not aware of any blue-plate specials on either one of them. There are just too many families that can't afford a home because housing costs are growing faster today then their savings accounts.

In 1949, the monthly cost of owning a house with a mortgage took 14 percent of the average 30-year-old's paycheck; now it takes 44 percent.

College costs are rising, too, at twice the rate of inflation since 1980. In this decade, the real cost for attending college has risen six times faster than the median family income and five times faster than available financial aid.

Meanwhile, the countries that we are competing against save money, while we spend it. In 1988, American consumers saved approximately 4 percent of the money that they earned, and the Japanese were saving approximately four times that. No wonder that they have the money to pump into new products and technology and have a competitive edge. If your competitor can borrow the money for half what you are paying for it to build a new plant, he really starts out with an enormous advantage.

How do we get that savings rate up so we can invest in America's future? One way is to enact a Super IRA. You help people buy a house, go to college, and at the same time you stimulate savings.

I know that a lot of the economists used to argue that old IRAs didn't spur savings. The new studies, though, including several by economists we will be hearing from today, show that is wrong. Personal savings can be substantially increased with incentives for IRAs, and that is important because the pool to draw investment money from in this country just isn't big enough. We are depending more and more on foreign money. You just can't swim in a wading pool. But IRAs give us a chance to make that pool larger, and big enough for investors to dive right in—not to mention keeping the American economy afloat.

The Administration wants to spur investment by cutting the capital gains tax. That would help some, and I say that as one who has argued for capital gains cuts; but the IRA takes care of the average American.

Some people say, "Let's do both." That would be nice, but I don't know where we would get the money to do both, because both cost us some money. The drain on the Federal Treasury would be too great.

By expanding and restoring the IRA we would get a much bigger bang for the buck; we would give a tax break to millions of middle-income Americans who bear the brunt of the tax-paying burden.

Proponents of the capital gains cut now proposed say it would bring in some revenue at first. They are right on that; it is a quick fix. But after that, it would lose incredible amounts of money—$5 billion in 1993, and the red ink doesn't stop.

Playing up that brief initial revenue surge is a bit like that remark by the pitcher who served up a home run ball to Willie Mays. He said, "For 60 feet, it was a helluva pitch." [Laughter.]

The point is, what happens next? The revenue loss would raise the deficit, interest rates, and the interest payments on the Federal debt, and that interest gets paid with taxes on average folks who are already struggling to write the next mortgage check, or the rent check, for people still looking for that first home.

By expanding and restoring the IRA, we can help average families save for their future and at the same time invest in America's future. In a way, that is America's real capital gain, and that is important to all of us.

I defer to the Ranking Minority Member for any comment he wants to make.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Mr. Chairman, thank you.

Without getting into a debate on who is a middle-income American, I don't mind using the Chairman's statement "average" in terms of income.

When we did the Tax Reform Act of 1986, we had to eliminate many deductions in order to produce the revenue needed to reduce tax rates. Rates could have been reduced even further down to a top rate of 20 percent on incomes above $65,000, if we eliminated all deductions. There was always a trade-off, what were you prepared to give up in order to get the tax rates reduced?

When we examined IRAs in 1986, we were intrigued to discover that IRAs were heavily used by people who made $50,000 and above. Now, $50,000 and above is not average. You can define "middle income" however you want, but $50,000 is way above average income in this country.

So, in 1986, we chose to limit tax deductible IRAs to couples earning $50,000 or less, individuals $35,000 or less, or anyone who was not covered by their employer's pension fund.

Do you know what you discover today? In Oregon, at least, 90 percent of the individuals are eligible for a tax-deductible IRA and, as the Senator from Kentucky told me, in Kentucky 97 percent of all individuals are eligible for deductible IRAs.

So, if we adopt the Chairman's plan, without arguing as to whether we are trying to help the middle-income taxpayer, we are clearly helping taxpayers in the upper 10 percent of all tax returns filed—whether that is middle income or not, it is not the average taxpayer.

We also discovered something in 1986: If you are interested in retirement plans which benefit all income classes, 401(k) plans had broader participation in all income classes than IRAs. When a business had a 401(k) plan, janitors, clericals, and most other low paid employees participated. This was not true with IRAs. It was an exceptional person that had an income below $25,000 a year who participated in IRAs. They simply didn't have the cash flow to participate.

As we go forward and debate capital gains versus IRAs, there is one thing the statistics will very clearly show: An expansion of IRAs will cost the Treasury money. There is no debate about that. It is debatable as to whether or not a capital gains tax cut costs the

Treasury money. We could have 10 more hearings on that subject and we would be no further ahead than we are today. Perfectly credible people, with Ph.D.s in economics, who head excellent university economics departments will disagree as to whether a capital gains tax cut produces revenue. But I know of no economist who says that expanding the deductibility of IRAs produces revenue. You can back-load it and lose revenue in later years; you can front-load it and lose revenue now; but there is no way you can raise revenue by increasing the deductibility of IRAs.

So my question is this: At a time when we clearly have a budget crunch, is this a time to expand a retirement program that 90 percent of taxpaying Americans can already participate in? Do people want to give tax-deductible IRAs to the upper 10 percent of Americans, and in the process increase our budget deficit? Will IRAs increase the savings rate? The most recent congressional Research Service studies say the evidence is inconclusive.

We can have hearings, and examine studies from different business organizations—many of whom sell IRAs—that state IRAs increase the savings rate. But the congressional Research Service, who has no axe to grind on this, simply says the evidence is inconclusive.

We do know this: We had IRAs from 1981 to 1986, fully deductible IRAS for all Americans and our savings rate went consistently down. I am not talking about averaging 1980 through 1986 versus averaging 1987 through 1989, but I am talking about direction. While we had fully deductible IRAs, the savings rate went down, and down, and down. I don't know if IRAs had anything to do with the decline; all I am saying is, those are the facts.

Ironically, after the 1986 Tax Reform Act limited the IRAs somewhat—although, I emphasize again that roughly 90 percent of the Americans can still get tax-deductible IRAs—for 1987, 1988, 1989, the savings rate has been going up. It is now 5.4 percent. The average savings rate in this country is approximately 7–7.5 percent over the last 40 years. We had two years of 9 percent savings in the early 1970s. That is the highest savings rate in the last 40 years.

All during the fifties and the sixties, when this country was expanding productivity and doing sensationally, a 7 percent savings rate was the average savings rate. And I would opine that the reason the current savings rate is going up is because, demographically, older people save more than younger people. This is true regardless of the tax incentive to save. As people get older and have children they increase their amount of savings. As they get to their early forties, they have to put their children through college which requires additional savings. And as they get toward their late forties and fifties, they think about retirement, and they save for that.

I would be willing to bet if we did nothing in the tax law at all to add further incentives to save, by the early to mid-Nineteen Nineties you will see the savings rate back at the 6.5–7.5 percent range, due to the aging of the baby boom. I seriously question whether this is the time and the place to give a savings incentive to the upper 10 percent of income earners in America.

The CHAIRMAN. Mr. Secretary, we are pleased to have you. Would you proceed?

Senator ROTH. Mr. Chairman?

The CHAIRMAN. I would ask that we defer any further opening statements, and I will be delighted to let you have your speech at that time; but if I do this, Senator, we will have other members coming in, and we have a real time crunch here.

Senator ROTH. Mr. Chairman, I have great respect for you in your desire to move on. At the same time, this is one of the most critically important matters that are going to come before this committee.

It has always been a general rule of this committee, as well as the Senate as a whole that we have the opportunity to speak when we think it is important. I don't think that I have taken advantage of that in the past, but I do think that we are addressing a number of problems that some of us——

The CHAIRMAN. At least turn on his clock. Thank you.

All right, Senator Roth. Let me then proceed in the order of appearance.

Senator Moynihan?

Senator MOYNIHAN. Mr. Chairman, I look forward to hearing the Secretary.

The CHAIRMAN. All right.

Senator Roth?

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE

Senator ROTH. Well, thank you, Mr.Chairman.

I think what we are considering today is of critical importance, of critical importance because I think we have the opportunity of doing something that is important for America and important for the American family.

I congratulate you, Mr. Chairman, in coming out recently for an IRA, because I think it is a very, very important initiative.

As you well know, I have been a strong advocate of the IRA from the very beginning.

The CHAIRMAN. As we both have, Senator. As we both have.

Senator ROTH. As we both have. And I think that the fact that we both are supporting it today is critically important, because it helped lay to rest the idea that the IRA does not have an important incentive for American savings. So, I congratulate you, and I look forward to working with you in restoring the IRA to the American people.

One of the points I want to make is that the reason an IRA makes a difference, if we go ahead with what you and I are proposing, we will have once again a tremendous advertising campaign to promote savings. And don't tell me it didn't work; the IRA did work. We had something like $38 billion saved annually. And when we backed off of it, that dropped to $14 billion. It had a significant impact on the savings rate of this country.

But, Mr. Chairman, what I want to urge is that we have an opportunity, as I say, to do something for America. It is time we put aside partisan politics and worked together. It is time that we take steps that will provide the needs of this country. We cannot as a country continue to depend on Japanese savings for American investment and for American deficits.

What I would urge you and the others of this committee, as well as the Secretary of the Treasury, is that we move ahead in tandem. I strongly disagree that this is a situation of either/or. Mr. Chairman, we can have capital gains, and we can have IRA, and they are needed for America, both for reasons of savings and for reasons of investment.

The House, 2 days ago, demonstrated that there is strong bipartisan support for capital gains. And if we are going to become competitive, if we are going to have facilities, the most modern in the world, that can compete with the Japanese, we had better take some risks for America.

So I would urge—and I might say my good friend Bob Dole agrees with me—that we should work together in an effort to have a capital gains cut plus an IRA.

Now let me speak very briefly about my IRA, because I think it makes it possible for us to have both:

As you know, what I do, instead of giving the tax exemption at the beginning, we would give it at the end. That means that we can meet the requirements of Gramm-Rudman. Now, people are saying, "Well, it will cost a lot of money down in the future." Well, ladies and gentlemen, don't we have any confidence in the productivity of the United States? The reason we want savings is so that we have modern technology incorporated in our facilities, so that our economy continues to grow. And that is what we intend to do with our IRA.

Let me just address the one question—and then I am going to come to an end—the question of those on the lower end of the economic scale. We want those people to save as well. So what I propose in my IRA is that we have a 25 percent tax credit for those who have earnings of $25,000 or less, so that there is an additional incentive for those on the low end of the economic scale to save.

In closing, again just let me say, Mr. Chairman, that I congratulate you for providing bipartisan leadership in the desire to restore IRAs, but let us work together in taking the two measures that will help guarantee growth and jobs for America's future.

The CHAIRMAN. Thank you, Senator Roth.

In order of seniority at the start of the hearing, the next speaker would be Senator Rockefeller.

Senator ROCKEFELLER. No statement, Mr. Chairman.

The CHAIRMAN. Senator Riegle.

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MICHIGAN

Senator RIEGLE. Mr. Chairman, I know you are anxious to start, and I am not going to make a long statement. I just want to say I strongly support your proposal on the IRAs. We fought hard to prevent them from coming out of the Tax Code; I think we lost by two votes in the Senate.

I know the Secretary has made some positive comments himself about the value of IRAs as creating a new kind or adding to our long-term savings pool, and I have been encouraged by his comments that sound supportive of what you and I and others would like to do, and I am very interested to hear his thoughts.

The CHAIRMAN. Senator Daschle.

Senator DASCHLE. No statement, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, would you give us your testimony? We are delighted to have you, and thank you for finding it in your schedule to be able to present the views of the Administration.

STATEMENT OF HON. NICHOLAS F. BRADY, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary BRADY. Thank you, Mr. Chairman.

I have a written statement which I had cut down quite a lot in order to save some time; but perhaps, since the first part of my statement is on savings, and I don't believe there is a sixteenth of an inch difference between what you and I think about the savings pattern in this country, I will only remark this morning that I have provided to the committee, which I hope you all have, four or five charts which basically show the same kinds of conclusions that you have alluded to in your opening remarks.

The first chart, which is called Net Saving and Real Growth, shows the United States at the very left-hand corner of the chart, the least favorable chart, and at the right side which shows the rate of growth and the net saving as a percent of——

The CHAIRMAN. I am sorry, I don't believe we have those charts, Mr. Secretary. If your assistant would pass those around, it would be helpful to us.

Secretary BRADY. Mr. Chairman, while you were talking, what I said was that about half of my statement, which was foreshortened already, is on saving. And since listening to your opening statement, we aren't more than a sixteenth of an inch apart on the matter of saving. I will just submit that for the record.

The CHAIRMAN. Fine.

Secretary BRADY. And if you now have it, I would have us look for one brief moment at the charts which did accompany my written statement, which I'm sorry that you don't have.

The first chart simply shows, much as you described, that the United States in terms of growth and net saving as a percentage of GDP is in the least favorable corner of the chart, and Japan, not surprisingly, is in the more favorable position.

If you go on to the second chart, which shows U.S. Gross Savings Ratio, it shows that, although from the Fifties to the Eighties we were sort of on a flat plane, we have now headed down.

If you go to the chart, which shows Net Savings As a Share of Net National Product, the same figures are evident, that our saving as a percentage of net national product has been decreasing.

And if you look to the Moving Average, on the next chart, of the Total Budget Surplus, you will see that again we have slipped badly in the last 10 years, but as Gramm-Rudman and the work of Congress and the Administration to reduce the deficit is beginning to show some results, we are picking back up again.

The last chart basically just shows, that because of the fact that Government dissaving in the form of the fiscal deficit is increasing and the private saving rate is going down, as well, we have come

down from an average in the fifties, sixties, and seventies of around 8 percent down to around 3 percent now.

So none of those things disagrees with what has been said already, and I will just put them in the record.

The CHAIRMAN. All right.

I would like to pick up my written testimony at the following point:

Having looked at those charts, I think our challenge is two-fold. First, we must make significant reductions in the prospective Federal budget deficit. Second, we must identify efficient incentives for encouraging increased saving and investment. Those two things are obvious.

I would now like to switch to the discussion of IRAs.

The current rules governing IRAs, with which you are familiar, were adopted in the Tax Reform Act of 1986. Under prior law, all taxpayers, regardless of income or participation in a qualified retirement plan, could make deductible IRA contributions up to the lesser of $2,000 or taxable compensation.

The Joint Committee on Taxation's general explanation of the 1986 Act listed a number of reasons for changing the rules: The determination by Congress that IRAs had not discernibly increased aggregate personal savings; the increasing availability of other tax-favored retirement savings plans which are subject to non-discrimination rules; the concentration of IRA utilization among higher-income taxpayers; the belief that higher-income taxpayers would have saved without tax benefits, and the belief that the lower tax rates provided by the 1986 Act would in themselves stimulate savings. Many of these issues are still unresolved.

Under the 50-percent deduction IRA proposal, as we currently understand it, individuals who are not now eligible to make deductible IRA contributions would be allowed to deduct 50 percent of their IRA contributions. In addition, penalty-free withdrawals would be allowed for first-time home buyers and for qualified higher-education expenses. This proposal needs clarification on two important issues:

First, it is not clear from descriptions that we have seen so far whether these penalty-free withdrawals would be limited to new IRA contributions made after the effective date, or whether they would also be permitted from existing balances, which could include large distributions from qualified retirement plans that have been rolled over into IRAs. We do not support permitting penalty-free withdrawals of retirement plan rollovers.

Second, it is not clear to us how the 50-percent proposal would characterize early withdrawals. For instance, could taxpayers claim that their first dollar withdrawn represents a part of a contribution previously taxed? Would withdrawals be prorated, or would some other rules apply?

Beyond these two technical questions, the Administration cannot support the 50-percent proposal, because of its cost. The proposal, if effected in 1990, would cause $15.3 billion in fiscal years 1990 through 1994. Even if delayed until 1991, it would still cost more than $11 billion over the same period. In the current environment requiring budget stringency, we do not have the funds to pay for such an expenditure.

The original intent of the expansion of IRAs under the 1981 Act was to provide uniformly available retirement income for individuals and to stimulate private saving. However, at this time there is no firm consensus over whether IRAs were effective in meeting those goals. Furthermore, we simply cannot say at this time whether IRAs are the best vehicle for encouraging individual saving.

Before we conclude that we should spend well over $10 billion to expand the existing program, a number of questions about the effectiveness of IRAs as currently constructed should be answered.

The question of whether IRAs stimulate personal savings is related to the more general question of whether personal saving is responsive to the after-tax rate of return. Economists have not been able to reach a firm consensus on this point. Early studies seem to indicate that personal savings did not increase in response to tax incentives; more recent studies suggest that they may have encouraged more savings.

IRAs generally have a contribution limit of $2,000 per year. Many taxpayers have already saved more than this limit, and thus IRAs may provide little incentive for additional savings. In addition, there is no requirement that IRA contributions come from new savings. If someone simply moves from a taxable savings account to an untaxed IRA account but does not increase his or her savings, then the result of the IRA expansion will simply be lost revenue. Hence, some people question whether expanding IRAs to higher-income taxpayers will result in significant increases in personal savings.

One of the reasons that the verdict is still out on IRAs is that they were available to a broad part of the population for only a limited period of time. While we agree that this time was too short to tell whether IRAs were really effective in stimulating savings, it does provide a database which deserves analysis.

Ideally, savings incentives should provide a benefit to lower-income households as well as higher-income taxpayers. Under old law, as in effect from 1981 to 1986, most benefits went to higher-income taxpayers. Post-1986 IRAs have achieved a different and perhaps better distribution.

The 50-percent proposal, which would restore 50 percent of the deductibility of contributions permitted under old law for couples with incomes over $50,000, would have distribution characteristics of the old law. More than 80 percent of its benefits go to taxpayers with incomes over $50,000.

One possible alternative for lowering the current cost of IRAs is to allow tax-free buildup of interest income on non-deductible deposits. This type of back-loaded IRA has recently been proposed by Senator Roth in S. 1256. Although the timing of taxes and deductions is different, a back-loaded IRA is economically equivalent to a fully-deductible IRA, provided the individual's tax rate doesn't change. This means that the value of taxes collected on the two types of accounts is essentially the same.

The revenue costs of the fully-deductible IRA are up front; those of the back-loaded IRA arise in the future. However, out-year losses under such a proposal will be large.

Good saving incentives should also be as flexible as possible. Current IRAs are structured as vehicles for retirement saving alone.

Younger savers, faced with a lock-up of their funds until age 59½, may not participate for this reason.

There may be some merit in the provisions of the proposals under consideration which would allow penalty-free withdrawals for first-time home purchases, college education expenses, and catastrophic medical expenses.

Permitting loans from IRAs for these purposes might also be considered. Provisions such as these make IRAs more flexible savings devices and may be desirable in that they give individuals more freedom of choice over what to do with their savings. Moreover, they may be far less expensive than reinstating the deductible contributions.

The idea of opening up IRAs to more than retirement saving is new and intriguing and certainly deserves further study; however, this expanded penalty-free withdrawal should not be available for rollover IRAs from qualified retirement plans. These amounts derived from retirement plans should be preserved for retirement.

Further, we should consider limiting borrowing for purposes of funding IRAs. Borrowing is simply the opposite of saving, and borrowing to set up an IRA is nothing more than tax arbitrage.

If we take the time for careful deliberation, we can design savings incentives that work, that we can afford, and that won't be repealed when Congress feels the bite of lost revenues.

Lastly, we do not believe that the 50-percent deductible IRAs for higher-income taxpayers are a substitute for capital gains tax relief. A lower capital gains tax rate helps small and growing businesses which create most of our new jobs. Because new ventures often have difficulty raising startup capital, lower rates can create incentives for the kind of risktaking that leads to new technology and a competitive edge.

Relative to our developed trading partners, the United States has among the highest taxes on capital gains. Belgium, Italy, and The Netherlands don't tax capital gains at all. West Germany, doesn't tax the gain on assets held more than 6 months, and France and Japan provide a differential rate for long-term capital gains that is considerably below ours. The question is: Why should we be the exception?

Yesterday the House took the first step toward redressing this competitive disadvantage by passing a capital gains tax reduction. The Bush Administration welcomes this step and urges the Senate to take that step, as well.

Thank you very much.

[The prepared statement of Secretary Brady appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary.

Let me speak further to a couple of the points here:

To the question about who receives the benefits of a capital gains cut as expanded IRAs, you start to phase out the tax incentive for the IRA at about $24,000 for the individual and about $40,000 for a couple. If you take a couple that is making, say, $45,000, both of them earning a paycheck, they sure don't think they are rich. Yet, that is who this helps.

If we look at the capital gains cut as proposed on the House side that the Administration is supporting, 80 percent of those benefits

go to people making over $100,000 a year. And with the IRA proposal, 69 percent of those benefits go to people making under $100,000 a year. And you are addressing three of the major concerns of American families: buying that first house, being able to pay for the college education of their children, and saving for their own retirement.

I look at this headline in the Wall Street Journal: "Capital Gains Tax Bill Would Spur Asset Sales More Than Investment," and then it goes on to buttress the case, citing individuals and what they say about it.

Then you talk about the cost of the plan. Well, I get figures from the Joint Tax Committee that show me that the cost over 10 years of what the Administration is proposing is $67 billion. That is more than twice as much as what the Bentsen IRA Plan would cost, according to the Joint Tax Committee.

One of the problems I see in what you are proposing is that it is an instant gratification, that you get your big revenue bump right up front. I believe that is the "now-nowism" that Dick Darman was talking about. What you really need is to have some long-term planning for the benefit of our country. That's what we ought to be working toward, and I think that is what the IRA does.

Mr. Secretary, you talked about raising the pool of capital in our country. But the House proposal won't do that. Look at the yo-yo effect that you have in the House proposal. The capital gains tax rate would drop down to 19 percent or so for 27 months and then you jack it back up again, everybody is going to try to go out that gate. They will probably wait until the end of that 27-month period, and then dump their assets, sell them, before the rate goes up.

Now, the only argument I know, really, for a capital gains cut—and I have argued for that—is that it will increase investment later. But how do you have it there? I think you have a counterproductive effect. I think you have a destabilizing effect on the market. Those people that haven't sold in that period, or have acquired some new assets, are going to hold onto them until that next windfall comes along. I think that is sheer budget gimmickry, and that isn't the way we ought to approach this problem.

Would you comment on that, Mr. Secretary?

Secretary BRADY. I will, Mr. Chairman. You have raised a number of important points, and I am not sure I will be able to remember all of them; but, if I don't, please remind me.

First of all, in terms of capital gains, I am unable to completely comprehend the polemics of the discussion on capital gains, because it is alleged that the rich are getting a tax break. Well, if that were true, which I don't agree with, we are talking about generating revenues—in other words, inducing taxes from the rich. So I don't think it is a tax break; I think we are simply using a way of generating revenues by getting people to pay more taxes. So I think the polemics of this thing have disguised the fact that we are really talking about increasing taxes.

Second, I think the statistics will show that of those people paying capital gains, 74 percent had other income of less than $50,000. So I don't believe that the statistics bear out the fact that this is a break for the rich.

With regard to IRAs, as some of the changes are put forward, we are talking about giving a tax benefit to those people whose income is above $50,000, and that only represents 12 percent of the tax payers. So I think, again, statistics can prove anything, but I don't agree with the original conclusion.

With regard to the fact that the President's original proposal for capital gains costs $67 billion, that is the Joint Committee on Taxation's figure over 10 years. Our figure is that we lose $.9 billion, less than $1 billion, over a 10-year period for putting forward a proposition that we think will generate jobs and saving.

Now, you raise the point of the jagged proposal that the House has put forward in terms of the fact that it is only lasting two and a half years. My hope is that the Senate will do better and try to even out that proposition and come up with something that provides a longer term view. So politics, as you all know better than I, is a product of compromise, and that is the compromise that was reached in the House. I hope that we can come to something in the Senate which will give a longer-view.

The CHAIRMAN. Thank you, Mr. Secretary.

Senator Packwood?

Senator PACKWOOD. Mr. Secretary, you just stated again that roughly—I will say 10 percent, you say 12 of the benefits of the proposed IRA expansion will go to those who make $50,000 and above. Is that correct?

Secretary BRADY. That is correct.

Senator PACKWOOD. For those making $50,000 and below—because they have deductible IRAs now they get no benefit from this proposal.

Secretary BRADY. That is correct, if there aren't withdrawal benefits.

Senator PACKWOOD. Let me ask, in your experience, when a person buys an IRA or gets into an IRA program—I haven't seen your statistics on this, but I am asking your experience—I would assume they get into it and they stay in it for a number of years. I assume that the purchase of an IRA is not a one-time, one-purchase shot.

Secretary BRADY. That would be my assumption.

Senator PACKWOOD. Whereas, on capital gains, what were the figures you cited on other incomes under $50,000?

Secretary BRADY. Well, the studies we have show that 74 percent of the capital gains were generated by income tax filers who had other income of $50,000 or less.

Senator PACKWOOD. And part of the reason for this is many of the people who are often classified in the above-$200,000 level on capital gains, normally earn much less but for this one-time capital gain. It is a couple selling their house that they have lived in for 20 years, for over $200,000. Maybe they had built it for $50,000 and when they sell it 20 years later for over $200,000—and they are counted in the high income category for that year, are they not?

Secretary BRADY. Sure.

Senator PACKWOOD. You are a hardware store owner. You have worked 60–70 hours a week all of your life, and you have 15 or 20 employees. When you reach age 62 or 63 you decide to sell your business. If you sell it to your children or somebody else for

$500,000, you will have a large gain. You probably have never earned more than $30-40,000 annually during your lifetime, but that year you are counted as somebody who has income over $500,000, aren't you?

Secretary BRADY. You would be.

Senator PACKWOOD. And when we see these statistics of the beneficiaries of capital gains, everyone is lumped into that $100,000 or $200,000 figure. The income level would include the income from that one-time capital gain, the money you earned from the sale of the business that year.

Secretary BRADY. In that set of statistics, I believe that is correct.

Senator PACKWOOD. And it is unfortunate that we do not have the statistics of the average income of people over a number of years who suddenly have a one-time capital gain. We just don't have it.

Secretary BRADY. Yes, I am not aware that they exist. We might be able to get them, but I have never seen them.

Senator PACKWOOD. We had one economist who testified before this committee who attempted to do some research, but all that he had were one-year figures; not how much have you made in 1981-82-83-84-85-86. Did Mr. Gideon indicate you may have some figures?

Secretary BRADY. No. What he said was that they would be very long in coming, "Don't promise them." [Laughter.]

Senator PACKWOOD. Unfortunately, all of the figures are not run horizontally, they are run vertically, such as, "How much did you make this year?"

I would simply opine that on average the people who buy IRAs, have a higher average income over the years, than those who take capital gains.

I can't prove this because there are no statistics, but my intuition tells me that the reason people who make $20,000, $25,000, or $30,000 don't buy an IRA is they haven't got the cash flow to do it. They don't buy them, and they are not going to buy them if this bill passes because this bill doesn't help people earning below $50,000. They have all the benefits they are going to get now. They will participate in a 401(k), ironically, and that is why the incidence of income distribution on that kind of savings is infinitely lower and broader than on IRAs.

But I wish it were possible to supply the figures on how many of these people who have a $200,000 income or a $500,000 income generate it 1 year, and it is the year they sell their asset. When the Chairman says, "People who buy these IRAs, couples that are making $50,000 a year, do not consider themselves rich". Neither does the couple that has lived all of their life in Rochester or Schenectady and sells their house for $200,000 and attempt to live in retirement on money earned from that investment. They don't consider themselves rich either, nor are they rich.

Mr. Chairman, I have no other questions.

The CHAIRMAN. All right.

Senator Moynihan?

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Thank you, Mr. Chairman.

Mr. Secretary, do you know the great regard with which you are held by your former colleagues here and by this committee? I think I would feel constrained to say that when representatives of the present and previous Administration come to this committee and talk about increasing savings, they do have a problem. Today in the United States we have a savings rate one-third of that we had in the 1970s. Professor Summers will testify to that in a short while.

Now, there has been some change in the demography—Senator Packwood is right in speaking of the aging of the baby boom. But Americans cannot have changed that much in just over a decade. Our policy changed—supply-side economics made a big noise here in Washington about a decade ago; we talked about increasing savings, talked about all of those things, and it hasn't happened. I mean, demography, if I could say to Senator Packwood, is a very powerful point, always to be attended; but if the aging of the baby boom were to lead to some explanations, why is that Canada has twice the savings rate we do? Why are we just absolutely at the bottom, if not in consequence of fiscal policy driven by very strongly held views of the Administration?

You mentioned "dis-savings." We are now a debtor nation. We managed in 8 years to triple the national debt. We borrowed a trillion dollars from the Japanese and gave a party. And what have we to show for it, excepting that debt service now is the third largest item in our budget, Mr. Secretary?

Doesn't it pain you that the commentators that might be thought well disposed to the Administration are just saying, "My God, the idea of giving a capital gains benefit for 2 years is simply writing a check for $25,000 to every Republican contributor in the last campaign?" And, "Once the check is written, it will have to be somebody else who will pay for it later on; it only lasts 2 years."

I don't mean to be anything but open with you, but what is the credibility of this Administration with respect to savings? We have been put in a situation that could debilitate this Nation in the next century.

Secretary BRADY. Well, Senator, in the same spirit of openness that you have exhibited, I would only say I don't quite agree with your analogy of writing a check for $25,000, when that must represent taxes paid by people in the upper brackets. It is hard for me to understand why this whole discussion has to reach the level of rich versus poor. I don't think it is too helpful, frankly; but, to me, when the upshot of changes in the capital gains tax is to require more taxes from those people who are paying capital gains, then I don't see that that is a benefit. But it certainly may look so.

I would only turn you back to the statistic which I earlier quoted, that 74 percent of the people who paid capital gains were in a tax bracket of $50,000 and under. So, allowing this discussion to climb into the rich-versus-poor thing I just don't think helps too much, because if that is true, sir, we are talking about people selling their homes. I mean, we can't be talking about people who, if

that is their other income, have much material wealth. They must be selling small businesses. So, sure, there may be some things wrong with capital gains, but I don't think the rich-versus-poor argument is the right one.

Senator MOYNIHAN. I would hope that wouldn't be made either, and I hope I hadn't done. But can I just make this point, that Senator Packwood made? You do get a large incidence of capital gain realization in income levels below $50,000, but those are typically one-time events. It would be helpful for us to get that data.

And people do not have the option of selling their house until they are ready to leave it. Capital gains are made by people with equities, in the main, liquid enough to move in and out of markets. Everyone says the proposal we are getting from the Administration would just lead to large-scale liquidation, one time, to take advantage of a marginal rate of taxation by people who have accountants and think about things like that. And all it will do is pick you up $3 billion to get through fiscal 90, then it will cost you 10 times that much later on; but we are only living for the next 12 months.

I didn't mean to leave you with that pronouncement and no response, but I do thank you for your courtesy.

The CHAIRMAN. Senator Roth?

Senator ROTH. Mr. Chairman, again I regret that so much of this discussion seems to be aimed at what I would call "class war." I don't think that is the answer. I think a majority of the members of this Finance Committee have in fact in the past supported a capital gains cut, and if it was good in the past, I find it hard to understand why it isn't good now.

Now, we may argue as to how you fashion it, and I think the Secretary has already indicated an interest in looking at it; but to me the basic question is: What can we do to ensure competitiveness in our economy? What can we do to help the American family?

I would like to ask you, Mr. Brady, one question, if I might. Are you satisfied with the rate of individual savings in America?

Secretary BRADY. No.

Senator ROTH. Isn't it a fact that it is not in our interest to be dependent long-term on foreign savings, that currently we are depending on the Japanese savings to help fund the deficit, to help provide investments?

Secretary BRADY. Well, Senator, I wouldn't quite put the emphasis on it that you have, because I think the level of foreign investment, although it gets a great deal of publicity in this country, has not reached the highs that it has in the past. This country, going back to its inception, has been based on the confidence of foreigners.

So I take your point, but I wouldn't go quite as far.

Senator ROTH. Let me ask the question a little differently: Wouldn't it be desirable for the United States to have greater savings for American investment?

Secretary BRADY. Yes.

Senator ROTH. Mr. Secretary, Senator Dole and myself have a plan that would include both a capital gains rate cut and an IRA plus incentive for personal savings. I know you are not in a position that you want to give any firm answer at this time, but would

you seriously consider this proposal as one which combines desirable tax incentives for saving investments?

Secretary BRADY. Well, Senator, if you wanted to sum up the position that came out of my testimony this morning, it is simply this: I do not think at this particular moment, in light of the budget strictures that we are under, that we have enough clear knowledge that IRAs, produce savings, to include them at this particular point in time. There are good arguments on both sides of the case. And if we had to a zero budget deficit, I think it might be worthwhile saying, "Well, we don't know, but there is a lot of emotional appeal to this idea, and that might be good enough reason in itself."

Senator ROTH. Let me ask you this question, Mr. Secretary: If we could fashion an IRA and capital gains in such a fashion that it met the needs of Gramm-Rudman, would you give that serious consideration?

Secretary BRADY. If you are talking, sir, about back-loaded IRAs where the hit is on future generations, I think all of the evidence that I have seen is that IRAs that are back-loaded cost the same as ones that are front-loaded. It is just that different generations will pay for them.

Senator ROTH. Would you agree, however, that if we need adequate savings for purposes of investment, and that that can increase productivity, that is the goal? Whether it is a back-ended IRA or a forward, I think the purpose of IRAs is twofold—one to help the family, but, second, to provide the kind of investment that will increase productivity.

Just let me point out, Mr. Secretary, I remember back in 1980 and 1981 when Jack Kemp and I were talking about reductions in the marginal rate, which has become accepted since then. It ended in the longest growth period in the history of this country. Isn't the question now how we can become competitive and can keep this growth continuing? And doesn't that partly depend on greater savings?

Secretary BRADY. It does.

Senator ROTH. My time is up, Mr. Chairman. I thank you.

The CHAIRMAN. Senator Rockefeller?

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Secretary, with all due respect, I think it is something of a rich-versus-poor matter; that is, capital gains. I think what it is, essentially, is the President made a campaign promise and wants to keep it, regardless of the effects on the economy and regardless of the effects on those, in a sense, who really do gain from capital gains, or perhaps because of that effect.

Let me state it this way: You talk about the number of transactions that would take place under capital gains, and spread that across a rather larger part of the income community. But if I were to ask you what percentage of the amount of capital gains' gains would go to people who had incomes of $100,000 or over, you would respond in what way?

Secretary BRADY. I don't have those statistics. I can give you a statistic that I believe is accurate, that taking the $50,000 level that we were talking about earlier, I believe 44 percent of the gains go to that group.

Senator ROCKEFELLER. With other income of $50,000?

Senator PACKWOOD. I didn't hear the answer, Jay.

Secretary BRADY. The answer is that I don't have those statistics with regard to $100,000; but with regard to those taxpayers who have other income of $50,000 or less, they derive 44 percent of the gains.

Senator ROCKEFELLER. The second question I would ask: How do you defend it, regardless if it is an IRA or a capital gains? You are advancing the capital gains, and you are attacking the IRA; but I am trying to look at the capital gains, which I might say I thoroughly oppose.

In terms of the responsibility of the Administration, in terms of budget responsibilities, there are those who say that we are getting into sort of a gridlock here. We started taking $150 billion out of the economy in 1981 with the tax cut. I am sure it helped my income situation; I am not sure it helped America very much at all. In fact, I think many of the cuts in Medicare and a lot of the other generally competitiveness-issue matters that you are discussing have been weakened, and some savaged, precisely because of that cut back in 1981.

But here you are trying to talk responsibly about the budget, and then we all know, and you know, the President knows, that this doesn't lose money for the first 2 years, and so, yes, that is kind of nice, because the American people don't figure that out, and people can phrase it, "Well, it doesn't lose revenue," but you know that it is going to lose 5.7 in 1993 and 5.1 in 1994 and over 10 years it is going to lose $21 billion.

Now, how do you defend that in terms of the responsibility of the Administration to the budget process and the budget deficit, quite apart from whatever you might feel that the IRA is? How do you defend capital gains with respect to that?

Secretary BRADY. Well, first of all, Senator Rockefeller, the President's plan, which he submitted when discussions first started on this subject, did not have a two and a half year up and then out; it was a permanent cut in the capital gains tax, and over a 10-year period, the budget effect of that was nearly neutral—I think a loss of some $900 million over 10 years. So, that is the Treasury figure. With regard to the Jenkins-Archer Plan which just came out of the House yesterday, it is our hope that we can change that.

I would only point out that the Joint Committee revenue estimates assume that economic activity stays where it is. The whole theory and thrust of a capital gains decrease is that this promotes investments and jobs, and that this does something very dramatic for the economy as a whole. So, I guess it is the difference in the way you look at it. Our position is that this helps the budget.

Senator ROCKEFELLER. My final point would be that in the 1981 tax cut—I am just simply trying to make a parallel here—in the 1981 tax cut, the whole theory of that was that Americans would have a tax break, and they would save it, put it in the bank, make money available for job creation, investments, et cetera, on the per-

sonal side. And on the corporate side, that corporations would take that cash windfall and would then go in and modernize their plants, and would get into training their workers better—in other words, plow it back in. That was the whole theory. That is the way it was presented to the American people. Neither happened. In fact, I think the President signed that in July of 1981, and I think during the latter part of that summer industrial production capacity started going down tremendously sharply. U.S. Steel, for example, took that and bought Marathon Oil. U.S. Steel today is 65 percent oil and gas, 35 percent steel. Now, that is their business, and I don't object to it, but the theory didn't work in 1981; why do you think the theory is going to work this time?

Secretary BRADY. Well, Senator, I don't think you can assume whatever ills there were during the 1980 to 1988 period were due to the existence of a capital gains tax during 6 years of that period. There were some other factors there, such as short-term interest rates at 20 percent that developed because of the inflation of the Seventies. So, I am not sure that it is a cause and effect.

I am impressed by the fact that of our major trading partners—Japan has a 20 percent top rate on capital gains, and a 1 percent sales tax; Germany has no capital gains tax after 6 months; Belgium, Italy, Taiwan, all of the countries that are growing around the world don't have a capital gains tax.

Now, we can get into this discussion of who pays it and who doesn't pay it; but, when we are worried about having those countries eat our lunch, from a competitive point of view, I am for taking the tact that allows us to provide our corporations with the same kind of competitive advantages that they have. So, it just depends how you look at it.

Senator RIEGLE. Let me indicate that the vote is on. Senator Heinz is going to be recognized now. I am going to leave to vote, myself, and let Senator Heinz recess the committee when he finishes, if another member has not returned.

Senator HEINZ. Which will be in about two minutes.

Senator RIEGLE. I would like to ask the Secretary to remain, though, because those of us who have not had a chance to talk to him will be right back and very much want to engage in the discussion.

Senator Heinz?

Senator HEINZ. Mr. Chairman, thank you. I will not be able to complete my round because I will have to go, myself.

OPENING STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Mr. Secretary, one of the things I know you strongly feel is that America's competitiveness is prejudiced by our differentially high cost of capital. In major part, it is said that that higher cost of capital tends to make corporate business leaders make short-term decisions because they are anxious to get a quick return their buck. They don't invest in R&D, they don't invest in production engineering, they don't invest for the long term; they don't do all the things that we think we would like—and I think, myself, we should like—to have our enterprise system encouraged,

and that other countries seem to encourage maybe better than we do, and that that is because of this high cost of capital that we have.

And I think you have agreed, in theory, that the way to address that is to address the double taxation of the returned equity, although I know you are a pragmatist, and you feel that there is not the revenue to address that issue.

How does a capital gains cut address the cost of capital in a way that improves the competitiveness of the American economy, at least as this is structured?

Secretary BRADY. Senator Heinz, obviously, everybody who has money to invest in liquid instruments is comparing the rate of return that he might get on those investments. And if there is a capital gains tax reduction, if those people who are willing to put money down and to support growing enterprises get an incentive to do so, then, theoretically, capital will shift out of more conservative instruments—bonds, of one kind or another—towards capital formation projects which will produce more jobs and will lower the cost of capital at the same time.

Senator HEINZ. Well, if that is correct, then if we pass this legislation the stock market ought to go up. Is that true?

Secretary BRADY. Well, I don't know. I spent a long time in the stock market.

Senator HEINZ. Seriously, all other things being equal.

Secretary BRADY. Well, it certainly won't go down.

Senator HEINZ. If it won't go down, the question is, will it go up? If it doesn't do anything, it seems to me that is a problem.

Secretary BRADY. Well, I think it would be very positive. Without arguing that point, I think it would be a very positive note for the stock market.

Senator HEINZ. It is not theory, because if there isn't an effect, a macroeconomic effect, in the capital markets, it will not reduce the cost of capital.

Secretary BRADY. Well, I think over time it will produce a macroeconomic effect. It is the timeframe that we are talking about. Over time, I think that is correct.

Senator HEINZ. All right.

Mr. Secretary, I must go and vote. I apologize for leaving you utterly alone. There may be an opportunity for you to take matters into your own hands.

Secretary BRADY. That is all right.

Senator HEINZ. But we trust you.

The committee will stand in recess until the first available Senator returns from the floor.

[Whereupon, at 10:17 a.m., the hearing was recessed.]

[AFTER RECESS]

The CHAIRMAN. This hearing will be in order.

Mr. Secretary, I apologize for the interruption.

Senator Daschle?

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Thank you, Mr. Chairman.

Mr. Secretary, I have heard the statement made several times this morning that the largest amount of benefit to be derived from the capital gains reduction that you are espousing goes to those with incomes, outside of capital gains, of less than $50,000. In fact, you made a statement—I think you didn't mean to say it, but it would be interesting if you could clarify it for me—that is, you said "in tax brackets of those who have incomes of less than $50,000." Certainly you didn't mean "tax brackets."

Secretary BRADY. Other income.

Senator DASCHLE. Other income.

You probably read Donald Trump's book "The Art of the Deal," like I did.

Secretary BRADY. I didn't read it.

Senator DASCHLE. Well, you would enjoy it. But in "The Art of the Deal," Donald Trump talks about how he has spent his life making income through the art of the deal. I would guess the Donald Trump deals are all capital-gains sensitive.

Would not the definition, as you described it, allow Donald Trump to claim himself to be one of those who has an income outside of capital gains of less than $50,000?

Secretary BRADY. Other income? I can't imagine that his other income is less than $50,000, but it may be.

Senator DASCHLE. That is what I would think. So, what you are saying is that Donald Trump fits your definition of $50,00 or less in outside income, other than capital gains?

Secretary BRADY. I don't believe so. I think Donald Trump's other income would be more than $50,000. But, anyway, without arguing that point, Senator Daschle, what I am trying to do by putting that figure forward—and as I said earlier, others may wish this to be a discussion between the rich and the poor, and if it has to be that, that is too bad; we will have to work it out that way.

Senator DASCHLE. You will have to forgive us if it does become that, because the rich are getting richer in this country, and the poor are getting poorer, and we have to deal with it. If this affects that whole trend, you will have to forgive us for bringing it up.

I think it is really a mis-characterization, Mr. Secretary, of this whole question to say that we somehow have the right to discount capital gains income, as we consider who benefits by this proposal.

Now, let me just ask you: The Joint Tax Committee has indicated—and I think it is important as we consider the benefits that you have a position with regard to the accuracy of their report. It says that 3.2 percent of all taxpayers would receive 80 percent of the dollar benefit from a capital gains tax preference, that those who earn $200,000 or more, eight-tenths of one percent of the taxpayers, would receive 60 percent of the tax savings from a reduction in the capital gains rate. Do you disagree with that?

Secretary BRADY. I would have to take a close look at those figures.

Senator DASCHLE. Well, do you think they are in the ball park?

Secretary BRADY. Would you repeat them again?

Senator DASCHLE. "3.2 percent of all taxpayers would receive 80 percent of the dollar benefit from a capital gains tax preference. Those who earn $200,000 or more, a mere eight-tenths of one percent of taxpayers, would receive 60 percent of the tax savings."

Secretary BRADY. Well, I think all of these statistics, Senator, that we should look at is what is the character of those people who will be either exercising capital gains or——

Senator DASCHLE. Don't obfuscate the answer; just give me a "Yes" or "No" with regard to whether you think that is a ball park figure.

Secretary BRADY. I am not familiar with those figures. I would be glad to provide you with an answer. I don't recognize them.

Senator DASCHLE. It is interesting that you are so familiar with the fact that 74 percent of the people who benefit from a capital gains rate reduction earn outside income of less than $50,000.

I really think, if we are talking numbers, we also ought to be talking dollars and where the benefits go, and you are not willing to recognize that.

Secretary BRADY. No, I am willing to, and I would be glad to discuss this with you. I don't think it is unusual that I would be familiar with figures that I have thought about a little bit and not ones that I haven't.

Senator DASCHLE. Well, I am surprised that the Secretary of the Treasury would not have thought about income distribution as these proposals come before us.

Secretary BRADY. I have thought about it.

Senator DASCHLE. Let me ask you another question in the short time I have left, and that relates to your comment that we are actually increasing taxes here. I thought this Administration was not in favor of increasing taxes.

Secretary BRADY. It is in favor of not increasing taxes; but, over the years, the capital gains tax has been a method that has been accepted and is not regarded as a tax increase.

Senator DASCHLE. Well, now you are saying two things.

Secretary BRADY. I mean, you can turn the argument any way you want. Why are you against imposing more taxes on the rich?

Senator DASCHLE. The yellow light is on, so let me ask you one last question: The Treasury study itself has indicated that over a 10-year period of time this costs money; to do this, it actually is going to cost money. We are going to have to borrow the money to pay for this, or find some other way to pay for it; that is, take money that we would otherwise use to offset the deficit to pay for a capital gains rate reduction. Is the Secretary of the Treasury saying this morning that this is so imperative, that reducing capital gains is more important than reducing the deficit over a period of time?

Secretary BRADY. Senator, I don't know exactly which figures you are talking about. If you are talking abut the Jenkins-Archer proposal, it is correct that over a 10-year period it does lose money; over a 5-year period, which may be sufficiently far to look out, the Jenkins-Archer plan, according to our statistics, produces $2.6 billion of additional revenue and, on the Joint Committee figures, a figure of 1.5-minus. So, I am not familiar with the figures on which you are coming to that conclusion.

Senator DASCHLE. I know that my time has expired, but I have to tell you, you have got to be as cognizant of your own figures which say that over a period of time any capital gains reduction is going to cost money.

Secretary BRADY. That is simply not correct, sir. Over a 10-year period of time the President's proposal—and this must be within the area of various costs—$.9 billion, $900 million, over a 10-year period.

Senator DASCHLE. It costs money.

Secretary BRADY. Over a 5-year period, it produces a lot of money. And if you want to talk about capital gains proposals, if you have a simple one of a 30-percent exclusion for capital gains, it nets over a 10-year period $22.3 billion, according to our figures, plus. So I don't think that is the case.

The CHAIRMAN. Senator, I will have to ask you to conclude.

Senator DASCHLE. Well, this is the first time, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Riegle?

Senator RIEGLE. Mr. Chairman, I want to get into several items, but I would like to get in, first, to the holding period issue.

You mentioned in your statement that the West Germans have a holding period, I think you said, of 6 months; the Japanese have a lower tax rate for assets held over a longer period of time. There are other illustrations of people that are beating our brains out in the international competition area, where they take a very careful look at the holding period. And this is something that you, yourself, have talked about. You are no stranger to that subject, and you have expressed a concern about it, yourself.

But let me ask you, if a commodity trader in one of the commodity pits in Chicago does a trade and reverses the trade three or four minutes later, and makes a profit on that trade, that would be treated as a capital gain, although the holding period there might be five minutes or less. Is that right?

Secretary BRADY. I think that is correct.

Senator RIEGLE. Now, the same is true of somebody selling stocks in New York? A stock trader buys a stock at 10:00 and sells it at 2:00 and realizes a capital gain on that transaction.

Secretary BRADY. Senator, excuse me. I misspoke. I think that all of these plans are only effective after a year.

Senator PACKWOOD. A year's holding?

Senator RIEGLE. That is news to me.

Secretary BRADY. Jenkins-Archer, which is the one that is most current, Senator Riegle, does have a year holding period.

Senator RIEGLE. But did the Administration proposal have a no holding period?

Secretary BRADY. We could check it, Senator Riegle, but our memory serves that it did have a year's holding period.

Senator RIEGLE. So, anybody buying an asset——

Secretary BRADY. I think the point is true after a year, but it is just for a year.

Senator RIEGLE. Well, no, but it is a very important point. Because if what you are saying is, after this takes effect, anybody buying an asset in the future, after the effective date of this legisla-

tion, would have to wait a full year before they could cash it in and realize the lower capital gains tax rate.

Secretary BRADY. That is correct with respect to Jenkins-Archer, and I think it was correct with respect to the President's original submission. But that was some 4 or 5 months ago.

Senator RIEGLE. We will double check that.

So you are here saying that you favor a 1-year holding period, then, on capital gains? Is that correct?

Secretary BRADY. Certainly with respect to Jenkins-Archer, if that is the operative law of the land, we would support that. And, personally, I think a year holding period is fine.

Senator RIEGLE. Of course, that will not apply to anybody who has assets in-stream that they have held for longer than a year. If they have it longer than a year, once the law takes effect, they can effect a transaction and qualify for the lower rate, is that right?

Secretary BRADY. I think Jenkins-Archer is only prospective. You are correct. In Jenkins-Archer it goes backwards as well as forwards. You are correct.

Senator RIEGLE. Yes. I think it would be much more attractive if it were only prospective, and I would have thought that might be more attractive to you, because I know you have this concern about how we tilt the equation toward longer-term investment and saving, and upping the savings rate, and getting out of the churning operation.

What I am concerned about is, I don't want to do anything here that is going to speed up just transactional turnover. I don't want anything happening here that causes people to go for immediate gains, just like this. I think there is too much of that now. I don't want the corporate raiders who come in and extract greenmail to be able to have a preferential tax rate.

I want to say, too, that I think we have still not gotten a clear and direct answer as to who gets the bulk of the tax benefits under the capital gains cut, and I think we have to have that for the record. In other words, if you don't like the Joint Tax numbers—I would assume they are as objective as any, but if you don't like those numbers—in terms of who gets the bulk of the tax cut, not the number of people participating but the number of dollars that go to income groups, I think we have to have your assessment, not this minute but we have got to have it.

Secretary BRADY. Right. I would be glad to do that. I promised Senator Daschle, and I will.

[The assessment follows]:

Table 1.—DISTRIBUTION OF NET LONG TERM CAPITAL GAINS FOR RETURNS WITH LONG TERM CAPITAL GAINS IN 1985

[In Percent]

Adjusted Gross Income Class Without Capital Gains	Distribution of Returns With Long Term Gains	Distribution of Long Term Gains	Percentage of Total Returns With Long Term Gains
Less than $10,000	16.9	19.7	5.1
$10,000 to $19,999	16.5	5.9	6.5
$20,000 to $29,999	15.9	6.1	9.8
$30,000 to $49,999	24.7	12.0	13.6

Table 1.—DISTRIBUTION OF NET LONG TERM CAPITAL GAINS FOR RETURNS WITH LONG TERM CAPITAL GAINS IN 1985—Continued

[In Percent]

Adjusted Gross Income Class Without Capital Gains	Distribution of Returns With Long Term Gains	Distribution of Long Term Gains	Percentage of Total Returns With Long Term Gains
$50,000 to $99,999	19.7	17.5	24.6
$100,000 to $199,999	4.5	12.6	56.2
$200,000 or more	1.8	26.2	76.1
Total	100.0	100.0	9.9

Department of the Treasury, Office of Tax Analysis, March 14, 1989
Source: 1985 IRS Statistics of Income.

Secretary BRADY. Even my own statistics, which I quoted earlier, of 44 percent of the gains going to taxpayers of $50,000 and under would imply that 56 percent——

Senator RIEGLE. You are saying 44 percent of the total dollar gain would go to people under $50,000?

Secretary BRADY. With other income of $50,000. So, therefore, the Senator is correct; therefore, 56 percent must have to go to people with other income of $50,000 and over, sir.

Senator RIEGLE. I would like to study what you have in that area, but I would also like you to give us some spreadsheet. You know, you can do the break point at $100,000, or $150,000, or $200,000; but it would probably make sense to do the same break points that the Joint Tax Committee has done, so that, if you have got a different view——

I am also interested in knowing whether the Treasury uses a static analysis or a dynamic analysis, and I would like to understand that. Sometimes people, when they want the numbers to work—I don't say you, but the people that crunch the numbers—you know, they can really change the operating assumptions about behavior, and you can make the numbers nearly net out. Sometimes you can get within a billion dollars over 10 years if people are really skillful at it. I don't say that has happened here, but I have seen it happen before.

Secretary BRADY. May I answer your question about dynamic and static?

Senator RIEGLE. Yes.

Secretary BRADY. The Treasury estimators do, I believe, use a dynamic estimate, and the Joint Committee does not. So, that is the difference that exists.

Senator RIEGLE. May I just briefly make one other point, Mr. Chairman, along this line? I know my time is up.

The CHAIRMAN. Yes.

Senator RIEGLE. I think it is somewhat disingenuous—I don't say intentionally, but it has that effect in the debate—when we talk about people selling their houses, because we have a very clear and specific provision in the tax law which treats that a certain way for all people. And if people are selling a house and they realize a capital gain, under the age of 55—we have a different treatment for those over 55, which I will mention in a second—under 55, and they go out and buy a house of equal or greater value, they defer

any capital gains tax on that transaction. We have built that in there because we support housing, That is a huge chunk, by the way, of the capital gains transactions for people of lower-income levels. It is very important to differentiate it and to be honest about it.

Then when people hit 55, they get a $125,000 tax set-aside on any run-up in capital gain on their house. So we have built that into the Code. There is nothing else quite like it that applies to everybody in the society. So, there is a very specific item in there that accords a unique capital gains treatment on the run-up in a person's personal residence.

I will just tell you, from my own experience, most of the people in the country who have an appreciable capital gain, who are not in the high-income areas, have that capital gain on their personal residence—on their personal residence.

So to throw that in there and make it sound as if somehow this proposal does something quite unique in that area just really is not an accurate presentation, and it needs to be seen in the form that it really is.

I thank the Chairman for giving me the additional time to make that point.

Senator ROTH. Mr. Chairman?

The CHAIRMAN. Yes. Senator Roth?

Senator ROTH. I would like to ask a follow-up question. What impact would capital gains have on the farmer who has to sell his farm?

Secretary BRADY. Well, he would get capital gains rates. It would have a favorable effect.

Senator ROTH. And there is nothing built in to offset that; so, as far as the agriculture community, the capital gains could be a very important factor, is that correct?

Secretary BRADY. That is certainly true, Senator.

Senator ROTH. What about the small businessman, the retailer?

Secretary BRADY. Our feeling, Senator, is that it would be a great help to the small businessman. We may think, when people are thinking about capital gains, that it is only the rich people in the country that think about it; but from what I have learned from talking to people over the last several months—one lady came in with an 80-acre timber farm which she had had in her family her whole life, and believe me, she had figured it out.

The CHAIRMAN. Senator, I would like to keep the sequence here, if we can, the order of it.

Senator ROTH. All right, Mr. Chairman.

The CHAIRMAN. Let me state for the record, because some questions were asked about it and the statement made that the information was not available; but this is an interesting number from the Internal Revenue source on the sale of capital assets, that taxpayers, realizing only one capital gain, accounted for less than 18 percent of all capital gains realized in 1985, and that is the latest year we have records for it. Eighty-two percent of the value of capital gains realized were by those with more than one gain in 1985. Those are the numbers that we have.

Now let me tell you what our problem is. We have panels of witnesses. They have planes to meet. I would like to move on to that, if we can.

All right, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, we are most appreciative of your attendance and the testimony you have given. It helps us to understand better the Administration's viewpoint. However, we may disagree with it.

Thank you.

Secretary BRADY. Thank you, sir.

The CHAIRMAN. We have, next, two professors of economics, Professors Larry Summers and Jonathan Skinner.

We are very pleased to have you.

Dr. Summers, I know that you have an engagement that is a personal one, that you just can't miss, and I hope you haven't. Why don't you proceed, and then we will let you leave.

STATEMENT OF LAWRENCE H. SUMMERS, PH.D., NATHANIEL ROPES PROFESSOR OF POLITICAL ECONOMY, DEPARTMENT OF ECONOMICS, HARVARD UNIVERSITY, CAMBRIDGE, MA

Dr. SUMMERS. Thank you very much, Senator Bentsen. I am glad for this opportunity to testify before this committee on the important issue of how best to give tax incentives for saving and investment.

I want to make four points in my testimony:

First, increasing saving is a national economic imperative. There hasn't been any controversy about that here this morning. The principle point to recognize is that no amount of targeting or spurring of investment will solve our economic problems unless we increase the pool of saving. Without an increase in the pool of saving, extra investment means more borrowing from abroad, and, as a matter of arithmetic, increased borrowing from abroad means a larger trade deficit.

If we want to provide for more rapid productivity growth and for more competitiveness in American industry, there is no alternative to an increase in national saving. From that perspective, it is the saving issue that I would suggest should guide deliberation over alternative tax incentives.

Second, IRAs work as a device for increasing saving. The best available evidence suggests that of every dollar contributed to IRAs, something like 75 cents represents new money rather than the transfer of other assets. That conclusion is supported by evidence of a number of different kinds:

Most IRA contributors do not have extensive assets. The median level of assets of IRA contributors several years ago was just $8,000. Most IRA contributors do not make the maximum contribution, which suggests that the IRA still provides an incentive at the margin. A substantial fraction, close to one-third, of IRA contributors make their contributions at the last possible moment, in 1989, so to speak, rather than in 1988, suggesting that they are responding to the advertising that IRAs generate. All this suggests that IRAs work as an incentive device.

When the program was universally available, IRAs worked in large part because of the advertising that they stimulated. Recently, however, one major New York bank told me that they had reduced their advertising expenses on IRAs from $23 million to $10 million following the 1986 Act, and were on their way to phasing out advertising altogether.

This makes a difference. If you would look at the last page of my testimony, it is a graph showing what has happened to IRA uptake among those with incomes less than $40,000 since the program was eliminated in 1986. These are the people who were eligible and remain eligible, and you can see that their uptake of IRAs has fallen by 40 percent.

A final type of evidence demonstrating the effectiveness of IRAs comes from a comparison of the American and the Canadian experience, where one sees that at the time Canada put in a system of saving incentives, Canadian saving rose rapidly relative to American saving. This is further evidence that IRAs work as an incentive device.

Third, IRAs are a much better way to go than capital gains.

Let me make three points here. First, the effect of the House bill, if enacted, will be to reduce national saving next year and to increase consumption. By unlocking assets, by encouraging the sale of assets, by encouraging the receipt of cash, it will lead to more consumption, which means less national saving and a smaller pool of funds available for investment. IRAs, on the other hand, will make funds available for the long term. Moreover, a capital gains holiday will accelerate financial engineering directed at reducing corporate saving. If the President's capital gains proposal had been in place, the government's tax take from the RJR-Nabisco deal alone would have fallen by more than $1 billion. .

Let me comment briefly on the distributional issue, because that came up. It was asserted here this morning that the IRA proposal would benefit only those with an income over $50,000. If I understand that proposal correctly, the assertion is not correct. In fact, the IRA proposal will benefit those who want to save to purchase a house, and now can't, and those who want to save for college educations. It will increase the IRA uptake among those with an income less than $50,000.

On the subject of capital gains, it is important to recognize that those with incomes under $50,000, aside from capital gains, are often people who are exceedingly rich and, as the Senator noted, are realizing large amounts of capital gains.

Fourth and finally, I would suggest there is scope for improvement in either capital gains proposals or the IRA proposals now being discussed. The capital gains proposal could be greatly improved by making the benefits prospective and not applying them to gains that have already taken place. There is also the possibility of improving the IRA proposal by permitting both deduction up front or, as an alternative, a deduction that is back-loaded.

I believe that IRAs with only a back-loaded deduction would probably not be very successful, that it is the deduction that sells the IRA. But permitting back-loading as an alternative for taxpayers who preferred it would reduce the near-term revenue impact and would spread out the revenue cost of an IRA proposal.

[The prepared statement of Dr. Summers appears in the appendix.]

The CHAIRMAN. Well, that is very interesting. And, in all candor, I have been thinking about that.

Dr. Summers, measure for me, to the degree you can, the comparative stimulus to investment of a temporary capital gains cut and the IRA that we are proposing.

Dr. SUMMERS. The IRA will expand the pool of saving. That will lead to lower interest rates, lower capital costs, a stronger stock market, and increased investment. The temporary capital gains cut will not increase investment; it will have the effect of reducing investment. As companies' stocks are sold and the market goes down, because people take advantage of this one-time holiday to get their cash out, the result will be reduced rather than increased investment.

There is, further, the consideration that by encouraging people to liquidate the savings that they have accumulated in the form of assets, when they then liquidate those assets and start to consume the proceeds, putting pressure on the economy, the result will be higher interest rates, and those higher interest rates, also, will discourage investment.

The IRA bill is pro-investment. I think a "temporary" capital gains cut is actually anti-investment for the near term.

Those considerations are reinforced when you recognize the long-term revenue consequences for the Federal Government. In the case of the IRA, the near-term cost overstates the total cost, because the Government will get back taxes on my IRA contribution, eventually, at the time when I retire. On the other hand, the so-called revenue gains from capital gains are only an acceleration of tax payments, not a genuine revenue increase. People who would otherwise have realized capital gains 3 years from now, or 5 years from now or 10 years from now, realize them during the brief holiday period. The Government gets more revenue this year, but it is a case of prepaying taxes, not paying increased taxes. The Government loses more revenue, because it loses the additional interest in subsequent years. So, the larger long-term deficit impact of the capital gains proposal is another reason why it would actually reduce investment relative to the level of investment that would be there if that proposal was not enacted.

The CHAIRMAN. Give me a feel for the difference between the savings rates here and those in Canada, and why.

Dr. SUMMERS. The saving rate in Canada is now about twice the level of the saving rate in the United States.

The CHAIRMAN. Has it been comparable in the past?

Dr. SUMMERS. If you look at the graph in Figure 3, which follows page 8 in my testimony, I think it is quite suggestive. What you see is that following enactment of Canadian saving incentives in 1972 and 1976, incentives very much like IRAs, the Canadian savings rate rose and then eventually pulled away from the American saving rate. It took some time. It may be that at first IRA contributions are financed by putting money in that the individuals would have saved, anyway, but people like the median IRA contributor of 1986, who had only $8,000 in fully liquid assets, eventually run out

of the money to reshuffle assets and the saving becomes new, incremental saving.

I think IRAs have a good deal to do with the reason why Canada's saving exceeds ours by so much.

The CHAIRMAN. Thank you.

Senator Packwood?

Senator PACKWOOD. Doctor, let me ask you why, over 30 years, our savings rate has gone as follows: 7.5 percent, pretty much, in the fifties and the sixties, then it goes up to 9 percent in 1971–72 or 1972–73. In 1974 ERISA was enacted, and IRAs first appear, Keoghs are expanded, and finally in 1981 we have deductible IRAs for everyone, 401(k) plans, and vastly expanded Keoghs, and our savings rate declines during that entire time from 1981 until 1986?

Prior to 1974 we did not have much in the way of tax incentives for savings. Why did it roll along at 7 and 7.5 percent for 15 or 20 years, then go up to 9, and then, as we started to add tax incentives, the savings rate goes down and continues on down when we had all of these tax incentives, but then in 1987, 1988, and 1989 it goes up again?

Dr. SUMMERS. I would suggest that the causation runs in the opposite direction. It is because savings have lagged that the Congress has felt the pressure to enact a variety of different saving incentives.

What has caused saving to lag in the United States over the last 15 years relative to the level before? It think there are three or four important factors, and by and large they reflect accomplishments of the nation, accomplishments that have as an unfortunate byproduct a reduction in saving:

First, for the first time in our history the elderly live better than other segments of the population. People who once saw their parents impoverished and worried that they needed to prepare for their own retirement now see their parents, those over 65, living better than any other segment of the population and conclude that there is less need to worry about their own retirement.

Second, borrowing has become much easier. The extent of consumer debt, the extent of second home mortgages—it is in part that people are saving less; it is also the case that more of the saving that some people are doing is being absorbed not in investment in the economy but by the borrowing of other people.

Third, the economy has provided better insurance over time for people—the fact that there is a Medicare program now, the fact that there is more adequate disability insurance than there once was, the fact that there is more assistance for rainy days. It is a good thing to do, but it has caused there to be less saving.

Senator PACKWOOD. But why is the savings rate going up now?

Dr. SUMMERS. The saving rate has gone up for the last couple of years mostly because it had been depressed so much. It is still at a level that is well below its level prior to 1980. I think to explain that you would want to look to things relating to the timing of automobile incentive programs, you would also want to look to fluctuations in the rates at which corporations fund their pension plans.

You know, if you look at the number we call "personal saving," something like a third of that personal saving—it varies from year

to year—isn't really saving done by people at all; it is General Motors putting aside the funds to meet its future pension commitment; and fluctuations having to do with financial practices of corporations, in that number, are another reason why the savings rate is going up.

Senator PACKWOOD. Let me ask you a question. Is this a fair statement? We don't have any empirical evidence as to why the savings rate has gone up in the last two and a half years.

Dr. SUMMERS. In the last two and a half years it is difficult to explain the reason. Economist have closely examined the demographic possibility, and they have reached, by and large, the conclusion that Senator Moynihan stated, that over relatively short periods of time the age distribution of the population doesn't change enough for that to be any kind of large-scale factor, that it is true that 40-year-olds save more than 25-year-olds and there are going to be more 40-year-olds; but if you work through how large that difference is and how much the proportions of saving have changed, you can't explain a large part of it.

But I think most economists would agree that the change in the last couple of years doesn't represent any kind of trend, and that we wouldn't be certain, when the final numbers are revised a couple of years from now, that that increase in saving will still be there.

Senator PACKWOOD. Let me read you a statement. This is from the Library of Congress:

"A recent review of whether or not IRAs have produced an increase in national savings concludes that 'The evidence is ambiguous and contradictory. Tax-deferred IRAs provide a higher after-tax rate of return than currently taxable financial assets. However, a large portion of IRA investments is thought to be a transfer of existing savings. Furthermore, some new savings flowing into IRAs are savings that would have been accumulated anyway, with or without the existence of IRAs. Net additions to savings result only if the existence of IRAs leads to a reduction in consumption relative to income, a proposition that is difficult to prove with available data.' "

Is their statement accurate, or inaccurate?

Dr. SUMMERS. I think their statement represents a view that would have been much more fashionable 3 years ago than is fashionable among those who have studied the latest research.

I have recently had the opportunity to write a survey that has looked at a wide variety of evidence on this, both internationally and in the United States, and my conclusion was that the weight of the evidence suggested that IRAs did make a significant contribution to saving, and I suggested, as before, that the ratio of new saving to transfer was on the order of 2 or 3 to 1.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. Surely.

Senator Roth?

Senator ROTH. This sort of reminds me: it used to be the theory that the higher your taxes, the more revenue you got, and I think there are those who now question that.

But fundamentally, it seems to me the most important example we have is the one you have already used, and that is Canada.

Canada is not that different from the United States, and there is no question but what, with their IRAs, their individual savings have gone up very significantly. Isn't that correct?

Dr. SUMMERS. That is correct.

Senator ROTH. I am not interested in an argument about how we go to an IRA; there are many ways to approach the IRA, and I am just a strong believer that we have to have an IRA.

The one advantage, which I think would have to be sold through advertising, or otherwise, of the back end IRA is that it really does mean more tax savings for the taxpayer, assuming the same rates of taxation are in effect. Isn't that correct? In other words, if you save $1,000 a year under the current IRA, that is tax-free. But if you had your savings in there 30 years, so all the interest on that IRA came out tax-free, so that your savings are higher.

Dr. SUMMERS. Senator, it depends on whether one recognizes the time value of money. If one recognizes the time value of money and so compares a dollar this year with a dollar 10 years from now, recognizing the interest rate between now and 10 years from now, in that case the two alternative IRA devices yield exactly the same tax saving, assuming that you are in the same tax bracket at the time you make the contribution as at the time when you retire. If, as we used to say was likely—who knows, given the current level of tax rates—people are in a lower tax bracket at the time they retire, then the back-loaded IRA would actually produce less tax saving, recognizing the time value of money.

Senator ROTH. But as a practical matter, when you withdraw those funds from the IRA, that is likely to push you into a higher tax bracket.

Let me just give this illustration. If you had contributions of $2,000 from age 30 to 60 with an 8-percent yield, you could withdraw $24,922 under my IRA, the IRA-Plus. Now, if you front-end that, that would be something like $21,000 if you were in the 15-percent bracket. So, in a sense, you do have greater cash available without taxation at the end than you do under the front-ended program.

Dr. SUMMERS. Senator, with respect, I believe your example must have been constructed in some way that did not take account of the time value of money. It is a basic part of the arithmetic that, if the deduction is in the same tax bracket as the subsequent payment, it doesn't make any difference which of the two devices are used.

Senator ROTH. That would also depend on what you did with your savings, wouldn't it?

Dr. SUMMERS. Yes, assuming you earn interest on your savings.

Senator ROTH. So in other words, you would have to save that $150 or whatever you saved from the up-front deduction to make that true.

Dr. SUMMERS. Assuming that you would have attempted to consume in the same way in both cases, which is the natural approach in analyzing these things, I would stand by my statement.

Senator ROTH. Well, I think the difference is what you do with that tax saving.

But, anyway, let me raise one further question. I think one significant difference in the IRA that the Chairman and I are both

proposing is that you could make withdrawals—that is, without penalty.

Would you have a penalty under yours?

The CHAIRMAN. Well, insofar as the withholding, you would have a credit for half of what you put in. Half. You would have a tax-free build-up inside.

Senator ROTH. In any event, under my proposal you could withdraw up to 25 percent for three purposes: that first home, catastrophic health costs, and education. Wouldn't that provide greater incentive to our younger people to save?

Dr. SUMMERS. Senator Roth, I think you are right that, for people my age, the housing and the education looms as a greater need than retirement, and I think, if it is administratively workable, the provision in your bill—that, as I understand it, is not part of Senator Bentsen's bill—to permit deduction for catastrophic health costs, as well, is a good idea.

Senator ROTH. That those would provide additional incentives?

Dr. SUMMERS. Those would provide additional incentive for saving and would, I believe, motivate people to save.

I think one does have to be careful to avoid a situation where the IRA becomes a tax shelter, and that is why one has to be careful about the rules governing withdrawal, and they have to be designed carefully to avoid abuse.

Senator ROTH. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Symms?

Senator SYMMS. No questions, Mr. Chairman.

The CHAIRMAN. Senator Pryor?

OPENING STATEMENT OF HON. DAVID PRYOR, A U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Mr. Chairman, I am sorry I have gotten here late. I just want to ask Dr. Summers one question.

The first question is: Could we go back to capital gains for just a moment? I think you spent a part of your discussion on that.

I come from a timber State. Several of us here on this panel do. We get a lot of interest from timber growers—not necessarily the big corporations, but the timber farmers—about capital gains and the need for some restructuring of treatment there.

If there is a 2-year benefit for timber growers as passed by the House, what does this do? Do they go out and cut down all the trees and sell them at the same time, flood the market, depress the prices? Or is there a positive aspect of this that I am not seeing now?

I know you are Harvard; I don't know how much you know about growing trees, but——

Dr. SUMMERS. Well, Harvard used to have an arboretum, but they just sold it.

Senator PRYOR. Did you get a capital gains on it? [Laughter.]

Dr. SUMMERS. I am sure "unrelated business income," all of that.

I think the effect is exactly the effect that you would suggest: it is to encourage people to cut the trees down that they would have cut 3 years and 4 years and 5 years down in the next 2 years, and it is to accelerate the cutting.

My suspicion, though I am not an expert, is that the effect on reducing timber prices by glutting the market would probably not be too large, because there is a world timber market, and the change would probably not be large enough to have a big effect on timber prices. But I think there is no question that the effect would be to accelerate the rate at which people cut down the trees. That is just a particularly vivid example of the general principle that it would encourage people to live for now, in the next 2 years, rather than to live for the longer run.

I personally think that any capital gains change would be a mistake; but I think if there were to be a capital gains change, the Congress would be better off legislating something that was permanent, perhaps to take effect in a couple of years, than it would be doing something temporarily.

Senator PRYOR. Thank you very much, Dr. Summers. I am going to yield back the balance of my time, because I know we have other witnesses and other Senators who will have questions.

Thank you, sir.

The CHAIRMAN. We know Dr. Summers is trying to catch a plane.

Senator Chafee?

Senator CHAFEE. I had no questions, Mr. Chairman.

The CHAIRMAN. Thank you very much. Your comments have been very helpful to us, Doctor Summers.

Dr. SUMMERS. Thank you.

The CHAIRMAN. Dr. Skinner, you have been very patient. We are delighted to have you.

STATEMENT OF JONATHAN S. SKINNER, PH.D., ASSOCIATE PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF VIRGINIA, AND RESEARCH ASSOCIATE, NATIONAL BUREAU OF ECONOMIC RESEARCH, CHARLOTTESVILLE, VA

Dr. SKINNER. Good afternoon, Mr. Chairman and members of the Committee.

My name is Jonathan Skinner, and I am an Associate Professor of Economics at the University of Virginia, and Research Associate at the National Bureau of Economic Research. My own research interests are why people save and, in particular, the effect of taxes on saving.

I am pleased that Individual Retirement Accounts are being considered here, because I think they will contribute to long-term saving and economic growth.

As we have heard in previous testimony, the household saving rate is in trouble. But why, then, were IRAs nearly written out of existence in 1986?

I think the backlash against IRAs reflected a widely-held and, I believe, incorrect view that IRAs provided no new saving, just a tax windfall to the truly wealthy. The concern at the time was that a taxpayer could shuffle $2,000 from his taxable savings account into an IRA and deduct the $2,000 from his income on his tax return with no net increase in saving.

Since 1986, views on IRAs have changed. Steven Venti of Dartmouth College and David Wise of Harvard University have esti-

mated that only 8 cents of every dollar in IRA saving was shuffled out of previous saving; that is, roughly 90 percent of IRA contributions consisted of new saving.

In a study with Daniel Feenberg, I used a sample of 2400 tax returns from the IRS to test whether IRAs were new saving. Initially, we set out to disprove Venti and Wise. We thought at the time that IRAs were just shuffled saving. So this is an example not of believing and seeing; we really did think that IRAs were shuffled saving.

We expected to find that taxpayers who opened IRAs gradually removed assets from taxable accounts and pushed them into IRAs. Therefore, the smoking gun that we expected to find was a decline in reported interest and dividend income on their tax returns. To our surprise, we found exactly the opposite. Taxpayers who purchased IRAs tended to increase their taxable income as well as their IRA contributions by far more than those who did not purchase IRAs. Rather than disproving Venti and Wise, we ended up confirming them.

Now, we were still skeptical, so we tried another test. For example, wealthy families are likely both to save in other types of saving and in IRAs, and the correlation between IRAs and new saving could have been a statistical artifact. So we corrected for wealth, and we still found the results.

Now, one puzzling question remains: Why should IRA enrollees go on saving binges? Recall, Senators, that ads for IRAs were everywhere during the 1980s; they promised to make you a millionaire by the time you retired if you made an annual $2,000 contribution. And in fact, our study did find that one-third of the enrollees did contribute exactly $2,000, to the penny, even when they were eligible to contribute up to $4,000.

Now, why $2,000? I believe that the marketing blitz was effective at conveying both correct information, that you should save for your retirement, and incorrect information, that the upper limit was $2,000. Now, I might also add that I think many people thought that the lower limit was $2,000 as well, and this may have prevented many lower-income families from contributing because they didn't have $2,000.

One strong predictor of IRA enrollment was whether the taxpayer owed money to the IRS on April 14th—I can speak with personal authority in saying that that is why I opened my IRA; I owed money to the IRS, and this was the only way out—that is, a taxpayer in a 40-percent tax bracket prefers to open a $2,000 savings account rather than write an $800 check to the IRS.

The instant gratification of an IRA contribution was, I believe, a key factor in the popularity of the program.

Now, some recent proposals such as the IRA-Plus do not provide a current tax deduction but back-end the deduction. I have doubts that the back-end IRA will enjoy the same popularity with the public. I think the public buys IRAs so they can get their tax shelter just like the big investors do.

Let me make two comments on the proposals to open IRAs up for housing and education.

First, my concern is that people will end up forgetting about retirement and spending too much money on housing and education.

Now, it is hard to say that one can spend too much, but still I am concerned about a loss of retirement saving.

The second is that the expanded IRA may become the subject of tax abuse, because the opportunities to beat the system have increased. Just as an example, families could shelter a substantial amount of income by opening an IRA for each of their children.

Expanding IRAs have been considered as an alternative to lowering the capital gains tax rate. In my view, the expansion of IRAs is much more effective and direct at encouraging national savings. In 1986, net IRA savings was 54 cents of every household dollar saved.

In summary, Mr. Chairman, IRAs can be an effective measure for increasing household saving and encouraging long-term growth.

[Dr. Skinner's prepared statement appears in the appendix.]

The CHAIRMAN. That is very interesting, Dr. Skinner, from a skeptic to a convert. When you make that point about perhaps people forgetting about saving for retirement if they expend that money on higher education, or to invest in that first home, I can understand your point. But it also seems to me that that is not wasted, insofar as being toward their retirement, because for so many people that home becomes a part of that investment they use to retire on, when they finally sell it. And certainly higher education pays off in being able to earn more and ultimately save more. So, maybe they are not exclusive, but they are complementary.

Dr. SKINNER. Perhaps. My concern is that people may buy a larger first-time house than they otherwise would.

The CHAIRMAN. Most of us did. [Laughter.]

Dr. SKINNER. And you were probably glad of it.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. Doctor, you are one of the co-authors of the NBER 1989 Study.

Dr. SKINNER. Yes.

Senator PACKWOOD. One of their conclusions is, while IRAs may represent new savings, some IRA contributions would have been saved, anyway. Is that correct?

Dr. SKINNER. I would not characterize that as——

Senator PACKWOOD. As their conclusion?

Dr. SKINNER. I believe our conclusion was that we did not find evidence of the shuffling that we expected to find.

Senator PACKWOOD. No, I wasn't looking at that. In your first statement you say, "There is very little shifting of assets from existing savings to IRA." There are five or six conclusions. That was the first one you had.

Dr. SKINNER. Yes.

Senator PACKWOOD. I was going down and looking at the second one, where you say, "Some IRA contributions would have been saved anyway."

Dr. SKINNER. I don't recall that conclusion.

Senator PACKWOOD. All right. We will just skip that one, then.

When we did the Tax Reform Act in 1986, we tried to lower the deductions and tax rates. Was that a step going in the right direction?

Dr. SKINNER. Yes.

Senator PACKWOOD. Should we continue it?

Dr. SKINNER. Yes.

Senator PACKWOOD. Then, why back up on the IRAs?

Dr. SKINNER. Because I believe that IRAs assist in increasing national savings.

Senator PACKWOOD. If we should continue in that direction, and if a bill were to be introduced eliminating even more deductions, including IRAs, but if we really went all the way and said we will get rid of all of the deductions—State income taxes, home mortgage deductions, IRA deductions—you would say that would be a step in the right direction?

Dr. SKINNER. May I ask the Senator, would you include the capital gains, as well?

Senator PACKWOOD. Yes.

Dr. SKINNER. Actually, before I did the study I would say Yes. After I have done the study, I have really become a believer in IRAs.

Senator PACKWOOD. Do you mean you would continue the direction on lowering the rates and the deductions and get rid of the home mortgage deduction, real property, State and local property taxes, capital gains, charitable contributions; but you would keep the IRAs?

Dr. SKINNER. I think such a bill is beyond any that I have seen, so I can't really comment on that. [Laughter.]

Senator PACKWOOD. Actually, the 1986 Tax Bill was beyond what anybody had seen, also. I am just curious about your economic judgment, as to whether that would be a direction to wisely go in. I thought you said Yes.

Dr. SKINNER. Yes. I agree with that. And I would say, even if you took away everything, I would still be in favor of keeping the IRA.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Roth?

Senator ROTH. Well, thank you, Dr. Skinner, for your very interesting testimony.

Have you studied the Canadian experiment?

Dr. SKINNER. I am familiar with Professor Summers' work on the subject, yes.

Senator ROTH. And do you agree that that is a good example of showing how IRAs do work effectively?

Dr. SKINNER. I would say it is not entirely conclusive, because my own calculations suggested that IRAs don't account for that much of saving to entirely explain the difference. But I think it is very interesting research, and I believe it.

Senator ROTH. You believe it was a positive factor, is that what you are saying?

Dr. SKINNER. I believe this was not by coincidence. I believe that there was some causation between the Canadian retirement accounts and the increase in Canadian savings rates.

Senator ROTH. I believe that is all the questions I had, Mr. Chairman.

The CHAIRMAN. Senator Chafee?

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator CHAFEE. Thank you, Mr. Chairman.

Dr. Skinner, do you think that your predictions, your forecast, on increased savings as a result of IRAs would hold up in view of the low tax rates that we have now? In other words, clearly, when you have lower tax rates the incentive to get a deduction is reduced. The statistics you looked at showing the high rate of IRA savings and the decreased rate as a result of getting rid of the deduction, could part of that be due to the fact that the rates were lower?

Dr. SKINNER. Yes, Senator. I agree absolutely that the fact that there are lower rates means that the cash you get back will be less. But I think if you add on the State taxes, you can still get a pretty substantial number, which I think will still loom large in the taxpayer's mind.

Senator CHAFEE. Also, it seems to me that if people are really interested in savings—of course, what we are trying to do is to induce people to save—I don't think we can overlook the fact that a person still gets the tax-deferral on the inside build-up.

Dr. SKINNER. Is this a concern?

Senator CHAFEE. No. I just wonder if having the deduction available at the decreased rates is going to make all of that great a change, as you are suggesting.

Dr. SKINNER. I see.

Senator CHAFEE. Particularly when there is an inducement already to save, which is the build-up, tax-deferred.

Dr. SKINNER. It is my belief, and this is not shared by all economists, that individuals, when they save, are not always that sensitive as to what the after-tax rate of return is—and, again, I emphasize this view isn't shared by everybody. If they were, they would pay off their Visa bills, which pay a very respectable 18 percent.

My belief that the primary reason why people do buy IRAs is that they get the deduction up front, and that is what they really are thinking about when they put their money away.

Senator CHAFEE. All right. Thank you.

The CHAIRMAN. Dr. Skinner, thank you very much. We appreciate your testimony. It has been quite helpful to us.

Dr. SKINNER. Thank you.

The CHAIRMAN. We next have a panel with Julianne Thrift, who is Executive Vice President of the National Association of Independent Colleges and Universities; Mr. George Shaffer, the President of The Insurance Center, testifying on behalf of Independent Insurance Agents of America; and Mr. Dallas Salisbury, the President of Employee Benefit Research Institute.

Dr. Thrift, if you would proceed, please.

STATEMENT OF JULIANNE STILL THRIFT, PH.D., EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF INDEPENDENT COLLEGES AND UNIVERSITIES, WASHINGTON, DC

Dr. THRIFT. Thank you, Chairman Bentsen and members of the Finance Committee.

I am Julianne Still Thrift, Executive Vice President of the National Association of Independent Colleges and Universities. My association represents more than 800 private colleges around the country, from the large research and urban universities to the very small women's colleges and historically black colleges.

I myself went to college with the help of the savings of my parents and federal student financial aid. I am also a parent who is concerned, like most other Americans, about the education of my own children.

On behalf of the colleges and universities I represent and the 2.6 million students that we serve, we strongly support Senator Bentsen's plan for an IRA that would allow parents to save for the education of their children. At a time when federal grant dollars for students are eroding and the personal savings rate is very low, parents are also facing increasingly high costs to send their children to college.

Today I want to make three points: First, that we have evidence that Americans do want their children to attend college; second, that parents want to pay for it themselves, and are simply not saving enough to do so; and third, that your plan, Senator Bentsen, will solve many of those problems.

First, in a Roper poll that my organization commissioned, we found that three out of four parents of pre-college-age children do expect those children to attend college. The parents are quite smart to want their children to attend college, because, as you might know, the gap between the income of high school graduates and college graduates is much larger today than ever before. As recently as 1973, a 30-year-old man with a college diploma earned 16 percent more than the high school graduate. By 1986, that had increased to 50 percent. The gap between the earnings has gone from 16 percent to 50 percent in that short period.

I know you have seen other evidence on the gap between the haves and the have-nots in this country. I think the encouraging thing, Senator Bentsen, is that your plan will both foster self-reliance and allow for upward mobility as more people can afford to send their children to college.

Second, not only do parents want to send their children to college, our poll showed that two-thirds of these parents want to pay for it themselves. They think they are responsible for their children's education, and they want to pay for it. Unfortunately, the same poll showed that half of the parents are not saving now at all, and the half that are saving can afford to save only $500 a year. That simply won't pay the bills. I think we must provide an incentive.

The other thing we found, that we were quite amazed about, is that grandparents want to be part of the action. When we polled the general public, we found that half of the general public would be willing to save for young people other than their own children if there were an IRA type of tax incentive.

What we are finding that is quite a source of concern to us is that parents now are terrifically concerned about paying the bills for college, and they simply can't do it.

A recent study by another organization showed that simply to send your child to a two-year community college, if you have made no plans at all, you would have to have a family income of $50,000 a year. And to send your child to a four-year private university, with no prior savings, you would need an income of $95,000 a year. Americans must save for tuition.

Finally, Senator Bentsen, we think that your IRA plan is just what the doctor ordered. And it is not just the private colleges that think that; every higher education group in Washington has signed a letter to thank you for your efforts.

In 1986, 87 percent of Americans who used the IRA deduction came from families making $75,000 or less. These are the families that aren't eligible for Federal grants to help pay for college, but they also don't have the funds to pay for college out of their current income.

I would just add, in closing, that the real genius, of this plan is not only can people save for the future, but the people who are feeling terrific stress today could use funds from existing IRAs to help their children.

Senator Bentsen, Senator Packwood, I appreciate the time to testify today and would welcome any questions.

[Dr. Thrift's prepared statement appears in the appendix.]

The CHAIRMAN. Thank you, Dr. Thrift.

Mr. Shaffer?

STATEMENT OF GEORGE R. SHAFFER, PRESIDENT, THE INSURANCE CENTER, TESTIFYING ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, ALBUQUERQUE, NM

Mr. SHAFFER. Thank you, Mr. Chairman.

I am President of The Insurance Center, a small business in Albuquerque, New Mexico, and Chairman of the Government Affairs Committee for the Independent Insurance Agents of America. I appreciate the opportunity to testify on the Bentsen IRA proposal today.

It is no secret that foreign capital helps to keep our economy afloat, and it is no secret that unabated consumerism has stifled savings in this country.

For many years the Tax Code has favored debt financing and consumption, while discouraging savings and capital formation. The IIAA believes that the Bentsen IRA proposal is a major step in the right direction, one that will help rectify the dismal national savings rate, which is lower than all of our major international competitors.

Economists have forewarned us of the dangers of low savings rates; and, while IRAs may not be the single answer for our low savings rate, they will make a significant difference.

After the 1986 Tax Reform Act, contributions to IRAs declined by approximately $25 billion, a cutback of nearly 62 percent. Even after factoring in a shifting of savings, these statistics do not bode well for our GNP and international competitiveness.

IIAA believes the Bentsen IRA proposal will make American business more competitive, in general, and the insurance industry, in particular. As independent agents, we are uniquely situated in the small business community and in the insurance industry, one of the most interest-rate sensitive industries in the nation. The Chairman's proposal should help to lower interest rates, a benefit for small business, but a result that could make the insurance industry more competitive on an international basis and ultimately benefit American insurance consumers.

The property-casualty insurance industry is known for its cyclical business trends, which bear a direct correlation to interest rates. A contributing factor that led to the last hard insurance market was cash flow underwriting, an insurance company practice that was exacerbated by high interest rates. Low and stable interest rates would certainly help put the brakes on the cyclical nature of the property-casualty industry, which we believe would ultimately help the consumer.

The unprecedented economic growth of our country over the last 9 years has been good news for the business community, but there are signs both in the insurance marketplace and the economy in general that cause small business owners concern. Both our monetary and fiscal policies must be in sync to reduce interest rates if we are to remain competitive in domestic and world markets.

In addition to the macroeconomic benefits of IRAs for the U.S. economy and the insurance industry, they will definitely benefit the average American family. I can personally attest that IRAs as a savings vehicle for college education would be an invaluable incentive for many families. Even though many independent agents have Keoghs or 401(k)s, we believe IRAs would be widely used as vehicles for additional savings, surely for retirement but also for the added benefits, especially penalty-free IRA withdrawals for higher education expenses.

IIAA agrees with Jonathan Skinner, who previously was on this panel, who found through empirical evidence that IRAs represent new savings. Granted, some will shuffle assets out of taxable accounts and into IRAs, but we believe many small business owners, including independent agents, will simply add another $2,000 in savings to an IRA without shifting their funds from taxable vehicles.

Mr. Chairman, there are many areas of the Tax Code that need further improvement, but the Bentsen IRA proposal, by creating incentives to save and at the same time providing options for some of life's necessities, helps keep our nation competitive in the rapidly changing international marketplace and it will be a boon to American families.

Thank you.

[Mr. Shaffer's prepared statement appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Shaffer.

Mr. Salisbury?

STATEMENT OF DALLAS L. SALISBURY, PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE, WASHINGTON, DC

Mr. SALISBURY. Mr. Chairman, it is a pleasure to be here. I will try to be brief, under the pressure of time.

I am providing my testimony today based upon data from the Census Bureau, released for the first time on September 15 of this year, so it is not data that has been available to the Joint Tax Committee or others.

That data indicates some interesting statistics compared to IRS data on deductible IRAs, particularly that the number of those contributing to IRAs since tax reform has decreased far less than the tax-deductible data would indicate.

For example, the Census Bureau data reports that nearly 600,000 individuals reporting earnings of more than $50,000 made non-deductible IRA contributions in Tax Year 1987, which would tend to support the statement by Senator Roth that the deferred inside build-up is a forceful incentive.

In terms of the distribution of IRAs, they have not particularly changed the drop off as expected; it has primarily been among those above $30,000 in earnings. But the total drop off, deductible or non-deductible, still represents less than 3 million individuals out of the entire society.

The data in this report also provides information on 401(k)s, and the pre-tax-reform and post-tax-reform information there is particularly instructive, in that pre-tax-reform only 7.2 million workers had 401(k)s available to them. By 1997, that had increased to 27 million. Pre-tax-reform total contributions, compared to post-tax-reform, increased by a significant amount greater than the estimate of the $25 billion IRA contribution loss.

Senator PACKWOOD. Excuse me. Does that mean available, or they used them?

Mr. SALISBURY. Over 50 percent used them, and the number using them increased to 16 million by tax year 1988. So, by the 1988 tax year, more individuals contributed to 401(k) plans than had ever been reported to contribute to Individual Retirement Accounts, as a historical matter.

And 401(k) plans, in addition, have an extra tax value, in that normally the individual has an employer matching contribution to go with their contribution.

I raise this data in terms of the issue of, if one were to change the law again, the impact of the IRA expanded deduction; simply stated, that at this point in time 27.5 million individuals have 401(k) availability they did not previously have, which might decrease the take-up of IRA deductions prospectively.

I would add, vis-a-vis your proposal, Mr. Chairman, that the housing and education provision could well lead individuals to put more in rather than less, compared to a pure retirement provision; but in an overall retirement income sense, it might more appropriately be sold and labeled an "Individual Housing and Education Account" than an "Individual Retirement Account."

In terms of the savings issue, I would note that 401(k) plans in Tax Year 1988, by our estimates, had contributions of over $50 billion, compared to pre-tax-reform contributions of only about $12.2 billion, and it is that growth of 401(k) plans that have in fact helped contribute to increases in the national savings rate.

Vis-a-vis the testimony of Mr. Summers, I must add one point: The tax changes in the area of pension plans actually have significantly depressed the national savings rate, and pension plans have been pulled somewhat out of those figures, since in 1988 benefit payments out of corporate pension plans exceeded contributions by $22 billion. Investment earnings in those plans in that same period were over $220 billion in increased assets from investment earnings, but those assets don't get counted as national savings.

Contrary to Mr. Summers' statement that that is mainly corporate money and not individual money, I would note that over 50 percent of it was in defined-contribution individual account plans

that inures directly to the benefit of individuals who have full vested rights to those accounts.

In short and in summary, I would note that Individual Retirement Accounts, based on our research, do in fact increase total aggregate savings, that employment-based programs, however, both in the amount of money saved and the overall impact, are far more effective across the income distribution than are Individual Retirement Accounts, and, because of expansion of the use of those programs, we expect that both the revenue losses attributable to your proposal and the number of individuals that would save in response to your proposal would both be lower. I guess the good news of the revenue loss is, it has less impact because of that lower potential usage.

With that, I would be happy to answer any questions. Thank you very much.

[Mr. Salisbury's prepared statement appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Salisbury.

Let me state that I am very appreciative of the testimony. Obviously you have had some differing points of view. And insofar as other private retirement plans, I applaud them; but I applaud anything we can do to try to increase savings in this country that has credibility. I think the IRA very much has that, and I believe there has been a substantial change in viewpoint by a great number of economists in the amount of new savings created by the IRA.

There is no way we are going to compete in this world unless we can get interest rates down in this country, whether it is savings on the budget, 401s, or IRAs. And for American families, who are more deeply concerned all the time about those children going to college, this won't solve all of that problem, if we put this into law; but it will sure help. It will help close the gap and make it more possible for them. Most of those children will have to supplement it with working in college.

I was talking to Charles Gibson the other day. He was telling me that he knew my son very well—he is an anchor man on ABC. He said he knew my son very well, because they both sold pizzas at Princeton, going to college, to help them pay their own way, because my son's old man wasn't putting enough in his bank account. [Laughter.]

But thank you very much for your testimonies.

Senator Packwood?

Senator PACKWOOD. Mr. Salisbury, do you know the incidence of income for people who have 401(k)s versus IRAs?

Mr. SALISBURY. Yes. That is in the table that is there. If one looks at those with 401(k) plans—it is labeled Table 3—one finds much heavier participation at lower income levels than in the case of Individual Retirement Accounts, both pre-tax-reform and post-tax-reform. For example, those earning between $15,000 and $20,000 per year, those with the option to participate in a 401(k), 50 percent of them chose to participate, compared to all of those with an IRA available to them, 11.3 percent of them made contributions.

Senator PACKWOOD. Mr. Shaffer, let me ask you: In your statement you say IRAs "will definitely benefit the average American family. What is your definition of "average?"

Mr. SHAFFER. Well, I have about 50 employees and a 401(k) with a matching plan, and I wonder if that isn't a glitch in your comments about the savings; but my average employee I would say makes $20-25,000 a year and probably is one of two in a household that is working. But that is probably above average. I really would be hard-pressed to give you an answer, Senator.

Senator PACKWOOD. So, yours may be slightly above average, is that what you are saying?

Mr. SHAFFER. I would hope so.

Senator PACKWOOD. So, unless they are going to really think about putting aside money for education or for a home, which is the additional incentives that Senator Bentsen has, they have the same advantage under the present law that they would have under Senator Bentsen's bill?

Mr. SHAFFER. Except, with the loan provisions of the 401(k), which are being tightened down, the IRA that Senator Bentsen proposes is kind of like a Christmas/College Club. I mean, you save it, and then when your child gets ready to go to college——

Senator PACKWOOD. Well, except for the additional benefit that he adds, they have as much incentive to save now as they are ever going to have under an IRA, except for Senator Bentsen's addition?

Senator SHAFFER. That's correct.

Senator PACKWOOD. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you. It has been very helpful. I think the hearings have been good. I appreciate it.

[Whereupon, at 12:39 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted

Prepared Statement of Senator Lloyd Bentsen

We need to bring the IRA out of retirement and put it to work helping Americans save for the future. I want to restore and expand it to help finance the two biggest investments of Americans' lives: a first home and a college education. I'm not aware of any blue light specials on either one of those.

Too many families can't afford a home because housing prices are growing faster today than their savings accounts. In 1949, the monthly cost of owning a house with a mortgage took 14 percent of the average 30 year old's paycheck; now it takes 44 percent.

College costs are rising, too—twice the rate of inflation since 1980. This decade, the real costs of attending college have risen six times faster than median family income and five times faster than available financial aid.

Meanwhile, the countries we compete against save money while we spend it. In 1988, American consumers saved just four percent of the money they earned; the Japanese saved 16 percent. No wonder they have the money to pump into new products and technology, and get an edge in global competition.

How do we get that savings rate up so that we can invest in America's future? One way is to enact the Super IRA bill I introduced this week.

You help people buy a house, go to college and at the same time you're stimulating savings. Some economists used to argue that the old IRAs didn't spur savings. The new studies, though, including several by economists we'll be hearing from today, show that is wrong. Personal savings can be substantially increased with incentives for IRAs.

That's important because the pool of money available to invest in manufacturing new products just isn't big enough. You can't swim in a wading pool. But IRAs offer us a chance to make that pool big enough for investors to dive right in not to mention helping keep the American economy afloat.

The Administration wants to spur investment by cutting the capital gains tax. That would help some—I say that as one who has argued for a capital gains cut—but the wealthiest Americans would get most of the benefits.

Some people say, "Let's do both." Well, that would be nice. But we can't afford it. The drain on the Federal treasury would be too great.

By expanding and restoring the IRA, we'd get a much bigger bang for the buck. We'd be giving a tax break to the millions of middle-income Americans who bear the brunt of the tax-paying burden.

Proponents of the capital gains cut now being proposed say it would bring in some revenue at first, and they're right, to a point. But after that it would lose an incredible amount of money—$5 billion in 1993, and the red ink doesn't stop. Playing up the brief, initial revenue surge is a bit like the remark by that pitcher who served up a home run ball to Willie Mays: "For 60 feet, it was a helluva pitch," he said.

The point is what happens next: The revenue loss would raise the deficit, interest rates and the interest payments on the Federal debt. And that interest gets paid with the taxes of average folks who are already struggling to write the next mortgage check—or rent check for people still looking to buy a home of their own.

By expanding and restoring the IRA, we can help average families save for their future and at the same time invest in America's future. In a way, that's America's real capital gain, and that's important to all of us.

I look forward to hearing our witnesses' views on this proposal.

DESCRIPTION OF S. 1682, RELATING TO INDIVIDUAL RETIREMENT ACCOUNTS

(Prepared by the Staff of the JOINT COMMITTEE ON TAXATION, September 29, 1989, JCX-54-89)

INTRODUCTION

The Senate Committee on Finance has scheduled a hearing on September 29, 1989, on S. 1682 (introduced by Senator Bentsen and others on September 27, 1989). The bill would expand the current tax deduction for contributions to an individual retirement account (IRA), and permit certain distributions from an IRA without payment of the 10-percent early withdrawal tax.

This document,[1] prepared by the Staff of the Joint Committee on Taxation, provides a description of the background of the IRA provisions, present law, and the provisions of S. 1682.

I. BACKGROUND

Employee Retirement Income Security Act of 1974

The individual retirement savings provisions of the Internal Revenue Code were originally enacted in the Employee Retirement Income Security Act of 1974 (ERISA) to provide a tax-favored retirement savings arrangement to individuals who were not covered under a tax-qualified retirement plan maintained by their employer. Those who were active participants in employer-maintained retirement plans were not permitted to make contributions to an individual retirement account (IRA). As enacted in ERISA, the limit on the deduction for IRA contributions was generally the lesser of (1) 15 percent of the individual's compensation for the year, or (2) $1,500.

Under ERISA and present law, amounts withdrawn from an IRA are includible in gross income. In addition, a 10-percent additional income tax applies under prior and present law to early withdrawals. In general, early withdrawals are amounts withdrawn prior to the time the IRA owner attains age 59½, becomes disabled, or dies. The 10-percent additional tax is designed to ensure that the funds are used for retirement purposes.

Economic Recovery Tax Act of 1981

The Economic Recovery Tax Act of 1981 (ERTA) increased the deduction limit for contributions to IRAs and removed the restrictions on IRA contributions by active participants in employer-sponsored plans. Under ERTA, the deduction limit for IRAs was generally the lesser of (1) $2,000, or (2) 100 percent of the individual's compensation. Any individual was entitled to make a deductible contribution, even if the individual was an active participant in an employer's plan.

As reflected in the ERTA legislative history, the ERTA changes were motivated by congressional concern that a large number of the country's workers, including many who were covered by employer-sponsored retirement plans, faced the prospect of retirement without the resources needed to provide adequate retirement income levels. Congress concluded that retirement savings by individuals during their working years can make an important contribution towards providing retirement income security.

Tax Reform Act of 1986

The Tax Reform Act of 1986 (the 1986 Act), added the present-law restrictions on deductible IRA contributions by active participants in employer-sponsored retirement plans similar to those adopted by ERISA. In addition, the 1986 Act added the present-law rules permitting individuals to make nondeductible contributions to an IRA.

II. PRESENT LAW

Deduction limits

Under present law, the maximum deductible contribution that can be made to an IRA is generally the lesser of $2,000 or 100 percent of an individual's compensation. Individuals who are not active participants in an employer-sponsored retirement plan, single taxpayers with adjusted gross income (AGI) of less than $25,000, and married taxpayers with AGI of less than $40,000, may make the maximum deducti-

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of S. 1682 Relating to Individual Retirement Accounts* (JCX-54-89), September 29, 1989.

ble contribution. For taxpayers who are active participants in employer-sponsored retirement plans, the IRA deduction is phased out for single taxpayers with AGI between $25,000 and $35,000, and for married taxpayers with AGI between $40,000 and $50,000.

Taxpayers who are not entitled to the maximum IRA deduction may make nondeductible contributions to IRAs. As is the case with earnings on deductible IRA contributions, earnings on deductible contributions accumulate on a tax-deferred basis.

Taxation of withdrawals

Amounts withdrawn from IRAs (other than nondeductible contributions) are includable in income when withdrawn. Early withdrawals, e.g., withdrawals prior to age 59½, death, or disability, are generally subject to an additional 10-percent income tax (sec. 72(t)).

III. DESCRIPTION OF S. 1682 [2]

In general

The deductibility of an individual's contributions to an IRA is expanded under the bill. Generally, the bill permits a deduction of one-half of the otherwise nondeductible portion of the contribution made by an individual. The bill also allows withdrawals from an IRA without imposition of the additional 10-percent tax to the extent the amount withdrawn is used for either the purchase of a first home or for expenses related to certain education expenses.

Expansion of present-law deduction rules

Under the bill, an individual who contributes to an IRA may deduct the amount of the contribution that is deductible under present law, plus 50 percent of the contribution that is not deductible under present law. This additional 50-percent deduction is only allowed with respect to contributions that would otherwise have been deductible but for the active participant rule. The present-law maximum dollar limitation ($2,000) and other limitations relating to deductibility (e.g., the requirement that the IRA owner be under the age of 70½) continue to apply.

For example, assume that a married taxpayer who has a combined AGI of $45,000 and who is an active participant makes a $2,000 contribution to an IRA. Under present law, only $1,000 of this contribution is deductible because of the taxpayer's AGI level and participation in an employer's retirement plan. Under the bill, the taxpayer may deduct $1,500. This amount is the amount deductible under present law ($1,000), plus 50 percent of the nondeductible contribution ($500). If the same taxpayer contributes $1,500 to an IRA, then under the bill the taxpayer may deduct $1,250 [$1,000 + (.50 x $500)].

Withdrawals by first-time home buyers

Under the bill, withdrawals by first-time home buyers that are used within 60 days to acquire, construct, or reconstruct the taxpayer's principal residence are not subject to the 10-percent additional tax. A first-time home buyer is an individual who has not had an ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which the withdrawal relates. The date of acquisition is the date the individual enters into a contract to purchase a principal residence or begins construction or reconstruction of such a residence. The bill requires that the spouse of the taxpayer also meet this requirement as of the date the contract is entered into or construction commences. Principal residence is defined as under the provisions relating to the rollover of gain on the sale of a principal residence (sec. 1034).

Under the bill, any amount withdrawn from an IRA for the purchase of a principal residence is to be used within 60 days of the date of withdrawal. The 10-percent additional income tax is imposed with respect to any amount not so used. However, if the 60-day rule cannot be satisfied due to a delay in the acquisition of the residence, the taxpayer may recontribute all or part of the amount withdrawn to the IRA prior to end of the 60-day period. Any amount recontributed is generally treated as a rollover contribution (sec. 408(d)), except that the frequency limitation on rollovers between IRAs does not apply. The taxpayer may subsequently withdraw any recontributed amounts to pay for the purchase of a home.

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[2] S. 1682, the Savings and Investment Incentive Act of 1989, was introduced by Senator Bentsen and others on September 27, 1989.

Rules relating to expenses for education

Under the bill, withdrawals used by a taxpayer during the year for qualified higher education expenses are not subject to the 10-percent additional tax. Qualified higher education expenses are tuition, fees, books, supplies, and equipment required for courses at an eligible educational institution, as defined under the provisions relating to educational savings bonds (sec. 135). Amounts withdrawn may be used for the education of the taxpayer, or the taxpayer's spouse, dependents, or grandchildren.

The amount that may be withdrawn for educational expenses for a taxable year without imposition of the 10-percent tax is reduced by any amount that is excludable from the taxable income of the taxpayer under the provisions relating to educational savings bonds.

Effective date

The expansion of the deduction provisions is effective for taxable years beginning after December 31, 1990. The provisions relating to the exception to the 10-percent additional income tax apply to distributions on or after January 1, 1990.

PREPARED STATEMENT OF NICHOLAS F. BRADY

Mr. Chairman and Members of the Committee: I am pleased to have this opportunity to present the views of the Administration on the implications of our low national savings rate and on the proposed expansion of the Individual Retirement Accounts (IRAs) and in particular the 50 percent deductible IRA proposal. My written statement is divided into five main parts: a discussion of the implications of our low national savings rate; a description of current-law IRA provisions and their development; a description and discussion of the 50 percent deductible IRA proposal; and a discussion of our current knowledge of the effect of IRAs on savings; and design considerations for evaluating IRA proposals. I will close with a discussion of why the Administration supports a capital gains tax reduction.

The Bush Administration is concerned about the nation's low savings rate, and currently has a comprehensive study underway on how to raise the savings rate fairly and effectively. But we believe the 50 percent deductible IRA proposal is too expensive at a time when reaching Gramm-Rudman deficit-reduction targets is our first concern. IRA expansion could prove desirable, but only when we have achieved a consensus on the effectiveness of IRAs in promoting future savings.

NATIONAL SAVINGS

There is widespread agreement among business, labor, government, and academic analysts that investment in human and material resources is necessary in preparing for the future. Such investment depends upon an adequate supply of savings drawn from domestic and foreign sources.

The data demonstrate that there is a positive relationship between a nation's saving rate and its economic growth rate. As Exhibit 1 illustrates, countries that save more grow more. Saving and investment are crucial factors for promoting economic growth and meaningful jobs; for enhancing the nation's ability to compete in the rapidly integrating world economy; and for adjusting to the changing demographics of the workplace as the baby boom generation ages.

The U.S. economic record is impressive. We are about to enter the eighth year of sustained economic growth—a unique achievement. Americans enjoy a high standard of living, relatively low rates of inflation and unemployment, and progress has been made in reducing the unacceptable budget deficit and foreign trade deficit, although we need to go much further in correcting these two economic problems.

Despite the overall economic progress achieved, however, there is justifiable concern that the United States is not adequately preparing to compete in an integrated world economy. Its rates of national saving and investment are too low relative to our future growth goals and relative to the performance of other industrial nations.

The long-term savings performance of the U.S. economy from 1898 to 1988, measured as gross savings as a percent of the gross national product, has been stable, except for the 1930s and 1940s (Exhibit 2). From 1946 through 1988, the U.S. gross savings rate has averaged 15.9 percent per year. Since the late 1970s, however, a disturbing downward trend in the gross savings rate has become evident.

The same pattern of erosion is evident when considering net saving as a share of net national product, as we demonstrate with Exhibit 2. This figure removes depreciation from the calculation to create a better measure of the net additional resources available for expanding investment beyond the mere replacement of existing

assets. As indicated in Exhibit 3, total net saving, including all levels of government, has declined steadily since the late-1970s and is now well below the 1950–1989 average level. This erosion is attributable to the deteriorating trend of both private savings and the dissaving created by chronic Federal government budget deficits.

The pace of personal saving has deteriorated as the baby boom generation has matured, resulting in a national emphasis upon consumption. This measure declined to a 40-year low point of 3.2 percent in 1987, before recovering somewhat to 4.4 percent in 1988. During the first 8 months of this year there has been improvement—up to an annualized pace of 5.5 percent—but this figure is still well below the long-term average of 6.8 percent reported for the 1948 to 1988 period. It is too early to announce that Americans are reversing their recent habits, though the future aging of the baby boom generation may gradually improve the figure.

The negative effects of the government budget deficits are even more distressing. The deterioration of fiscal conditions is evident when the size of the chronic Federal budget deficits is compared to the overall output of goods and services (Exhibit 4).

The unfortunate diversion of private savings—the total accumulation of households and business—to finance public consumption is a fundamental risk for the future of the U.S. economy. This is particularly important if we are to improve national productivity by expanding capital investments to enhance our international competitive position. The summary table of national saving and investment rates contained in Exhibit 5 describes the challenge.

This exhibit points out that private savings have eroded in recent years at the same time that public dissaving (Federal budget deficits) have increased—leading to a large net reduction of national savings (the combination of private and public figures). This unfortunate combination has constrained net domestic investment.

Our challenge is twofold. First, we must make significant reductions in the prospective Federal budget deficits. Second, we must identify efficient incentives for encouraging increased saving and investment.

CURRENT LAW

The current law for IRAs grants married taxpayers who do not participate in a qualified retirement plan or who have adjusted gross incomes below $50,000 the right to make deductible contributions to an IRA. There are lower thresholds if the taxpayer is single or is married but does not file a joint return. Taxpayers who do participate in a qualified retirement plan and who have adjusted gross incomes above these thresholds may make only non-deductible contributions to an IRA. Both deductible and non-deductible IRA contributions are limited to the lesser of $2,000 or the individual's taxable compensation for the year.

Withdrawals from an IRA prior to age 59½ are subject to a 10 percent excise tax. In addition, most IRA withdrawals are subject to regular income tax. The exception is for distributions of amounts which were not deductible when contributed.

The current rules governing IRAs were adopted in the Tax Reform Act of 1986 (the "1986 Act"). Under prior law, all taxpayers, regardless of income or participation in a qualified retirement plan, could make deductible IRA contributions up to the lesser of $2,000 or taxable compensation. The Joint Committee on Taxation's *General Explanation* of the 1986 Act listed a number of reasons for the change: the determination by Congress that IRAs had not discernibly increased aggregate personal savings; the increasing availability of other tax-favored retirement savings plans which are subject to non-discrimination rules; the concentration of IRA utilization among higher-income taxpayers; the belief that higher-income taxpayers would have saved without tax benefits; and the belief that the lower tax rates provided by the 1986 Act would in themselves stimulate savings. Many of these questions still exist.

THE 50-PERCENT DEDUCTION IRA FOR HIGHER INCOME TAXPAYERS PROPOSAL

Under this proposal, as we currently understand it, individuals who are not now eligible to make deductible IRA contributions would be allowed to deduct 50 percent of their IRA contributions. In addition, penalty-free withdrawals would be allowed for first-time home buyers and for qualified higher-education expenses.

This proposal needs clarification on two important issues. First, it is not clear from descriptions we have seen whether these penalty-free withdrawals would be limited to new IRA contributions made after the effective date or whether they would also be permitted from existing IRA balances (which may include large distributions from qualified retirement plans that have been rolled over into IRAs) We do not support permitting penalty-free withdrawals of retirement plan rollovers.

Second, it is not clear to us how the 50 percent proposal would characterize early withdrawals: could taxpayers claim that their first dollar withdrawn represents the part of the contribution previously taxed, would withdrawals be pro-rated, or would some other rule apply?

Beyond these two technical questions, the Administration cannot support the 50 percent proposal because of its cost. The proposal, if effective in 1990, would cost $15.3 billion in FY 1990-94. Even if delayed until 1991, it would still cost more than $11 billion over the same period. In the current environment requiring budget stringency, we do not have the funds to pay for such an expenditure.

It should also be noted that more than 88 percent of all taxpayers had adjusted gross incomes of less than $50,000 in 1987. But under the 50 percent deductible IRA proposal more than 80 percent of all benefits will go to those who make more than $50,000, as Exhibit 6 demonstrates.

SAVING INCENTIVES

The Bush Administration feels that high rates of saving are fundamental to sustained long-run growth and the general competitiveness of the U.S. economy.

One of our efforts in this area is a study of personal saving and the cost of capital that is being prepared for the Cabinet's Economic Policy Council. The study will include a full discussion of private saving incentives, including IRAs. The Administration believes that IRAs deserve full and careful study and discussion, and that any proposal adopted should be a carefully structured program likely to achieve a real increase in saving.

The original intent of the expansion of IRAs under the 1981 Act was to provide uniformly available retirement income for individuals and to stimulate private saving. However, at this time, there is no firm consensus over whether IRAs were effective in meeting those goals. Furthermore, we simply cannot say at this time whether IRAs are the *best* vehicle for encouraging individual saving. Before we conclude that we should spend well over $10 billion to expand the existing IRA program, a number of questions about the effectiveness of IRAs as cur ently structured will have to be answered.

The question of whether IRAs stimulate personal savings is related to the more general question of whether personal saving is responsive to the after-tax rate of return. Economists have not been able to reach a firm consensus on this point. Early studies seemed to indicate that personal savings did not increase in response to tax incentives. More recent studies suggest that they may have encouraged more savings.

IRAs generally have a contribution limit of $2,000 per year. Many taxpayers already save more than this limit and thus IRAs may provide little incentive for additional savings. In addition, there is no requirement that IRA contributions come from new savings. If someone simply moves money from a taxable savings account to an untaxed IRA—but does not increase his or her other savings—then the result of IRA expansion will simply be lost revenue. Hence, some people question whether expanding IRAs to higher income taxpayers will result in significant increases in personal savings.

One of the reasons that the verdict is still out on IRAs is that they were available to a broad part of the population for only a limited period of time. While we agree that this time was too short to tell whether or not IRAs were really effective in stimulating savings, it does provide a data base which deserves careful analysis.

DESIGN OF SAVING INCENTIVES

Ideally, saving incentives should provide a benefit to lower income households as well as higher income taxpayers. Under old law as in effect from 1981 to 1986, most benefits went to higher income taxpayers. Post-1986 IRAs have achieved better distribution. The 50 percent proposal which would restore fifty percent of the deductibility of contributions for permitted under old law for couples with income over $50,000 would have the distributional characteristics of old law. More than 80 percent of its benefits go to taxpayers with incomes over $50,000.

One possible alternative for lowering the current cost of IRAs is to allow tax-free build-up of interest income on nondeductible deposits. This type of "backloaded" IRA has recently been proposed by Senator Roth in S. 1256. Although the timing of taxes and deductions is different, a backloaded IRA is economically equivalent to a fully deductible IRA (provided the individual's tax rate does not change). This means that the value of taxes collected on the two types of accounts is essentially the same: the revenue costs of the fully deductible IRA are up front; those of the

backloaded IRA arise in the future. However, out year losses under such a proposal will be large.

A good saving incentive should also be as flexible as possible. Current IRAs are structured as vehicles for retirement saving only. Younger savers faced with a "lock-up" of their funds until age 59½ may not participate for this reason. There maybe some merit in the provisions of the proposals under consideration which would allow penalty-free withdrawals for first-time home purchases, college education expenses, and catastrophic medical expenses. Permitting loans from IRAs for these purposes might also be considered. Provisions such as these make IRAs more flexible saving devices and may be desirable in that they give individuals more freedom of choice over what to do with their savings. Moreover, they may be far less expensive than reinstating deductible contributions.

The idea of opening up IRAs to other than retirement saving is new and intriguing, and certainly deserves further study. However, this expanded penalty-free withdrawal should not be available for rollover IRAs from qualified retirement plans. These amounts derived from retirement plans should be preserved for retirement. Further, we should consider limiting borrowing for purposes of funding IRAs. Borrowing is simply the opposite of saving, and borrowing to set up an IRA is nothing more than a tax arbitrage gimmick.

If we take the time for careful deliberation, we can design saving incentives that work, that we can afford, and that won't be repealed when Congress feels the bite of lost revenue.

IRAS ARE NOT AN ALTERNATIVE TO CAPITAL GAINS

Lastly, we do not believe that 50 percent deductible IRAs for higher-income taxpayers are a substitute for capital gains. A lower capital gains tax rate helps small and growing businesses, which create most of our new jobs. Because new ventures often have difficulty raising start-up capital, lower rates can create incentives for the kind of risk-taking that leads to new technology and a competitive edge.

Relative to our developed trading partners, the United States has among the highest taxes on capital gains. Belgium, Italy and the Netherlands don't tax capital gains at all. West Germany doesn't tax the gain on assets held more than 6 months. And France and Japan provide a differential rate for long-term capital gains that is considerably below ours. Why should we be the exception?

Yesterday, the House of Representatives took the first step toward redressing this competitive disadvantage by passing a capital gains tax reduction. The Bush Administration welcomes this step and urges the Senate to take that step as well.

Attachments.

NET SAVING AND REAL GROWTH

1960 to 1985

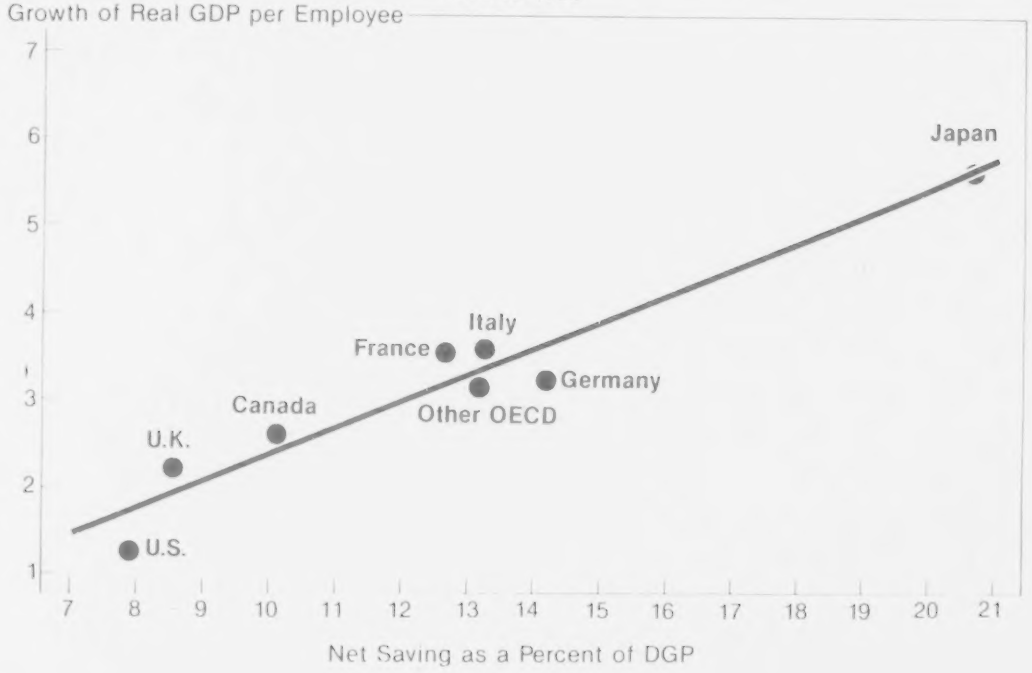
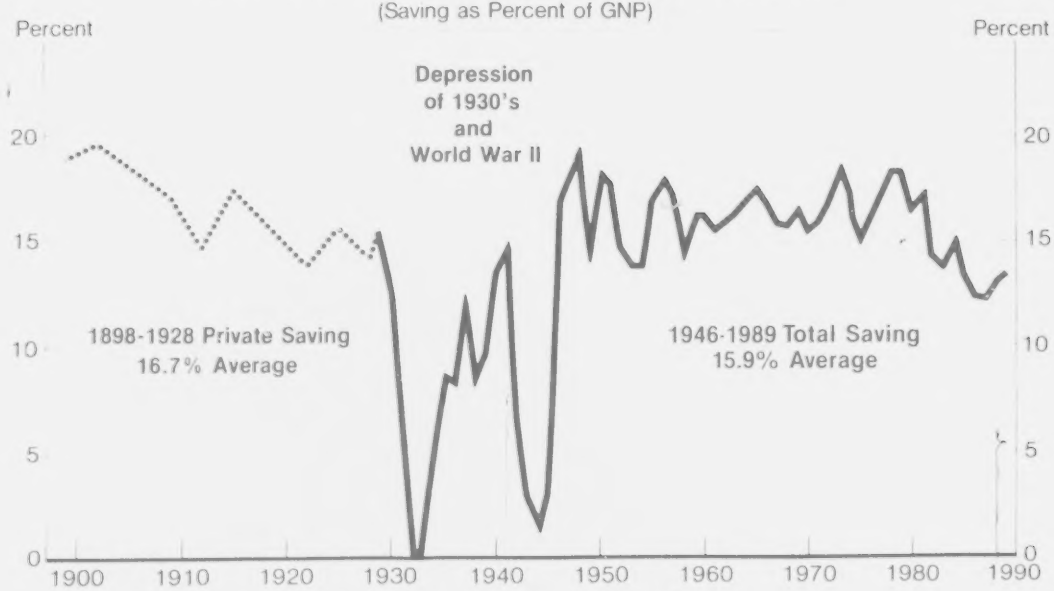


Exhibit 1

U.S. GROSS SAVING RATIO, 1898-1989

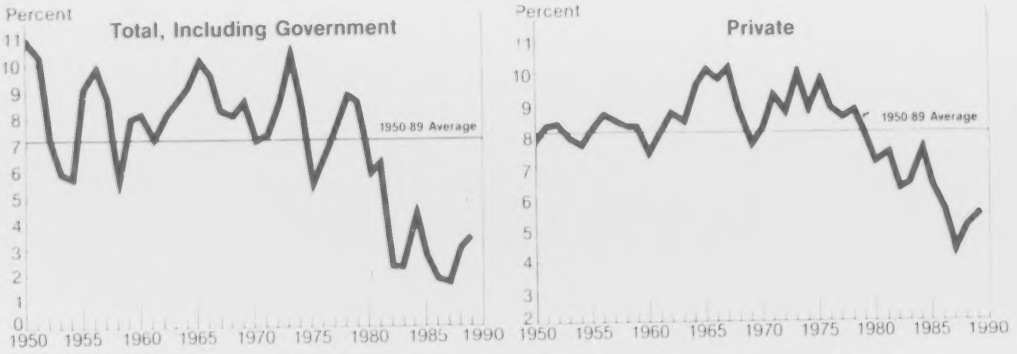
(Saving as Percent of GNP)



Note: 1898-1928 data from David and Scadding, Journal of Political Economy, April 1974
Data following 1928 are from U.S. Department of Commerce
Latest observation: first half 1989

Exhibit 2

NET SAVING AS A SHARE OF NET NATIONAL PRODUCT

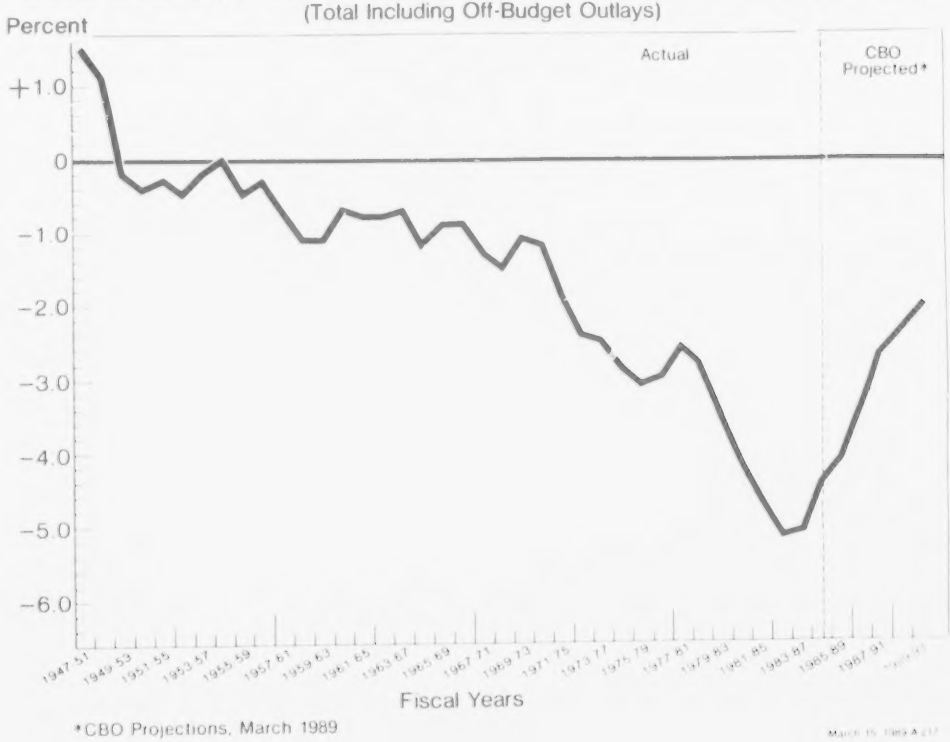


Latest observation: first half 1989.

Exhibit 3

FIVE-YEAR MOVING AVERAGE OF THE TOTAL BUDGET SURPLUS (+) OR DEFICIT (—) AS A PERCENT OF GNP

(Total Including Off-Budget Outlays)



*CBO Projections, March 1989

Exhibit 4

Net Saving and Investment as a Share of Net National Product, United States, 1951—88 [a]

Percent

Item	1951-1960	1961-1970	1971-1980	1981-1985	1986	1987	1988	1989 first half
Net saving								
Private saving [b]	8.6	9.5	9.7	8.2	7.1	6.0	6.8	7.2
Government saving	−0.8	−1.0	−2.0	−4.6	−5.3	−4.3	−3.8	−3.8
Net investment								
Net foreign investment	0.3	0.7	0.3	−1.3	−3.6	−3.7	−2.7	−2.1
Net domestic investment	7.7	7.7	7.5	5.0	5.3	5.3	5.4	5.1
Total national saving-investment [c]	7.8	8.5	7.7	3.6	1.7	1.7	3.0	3.4

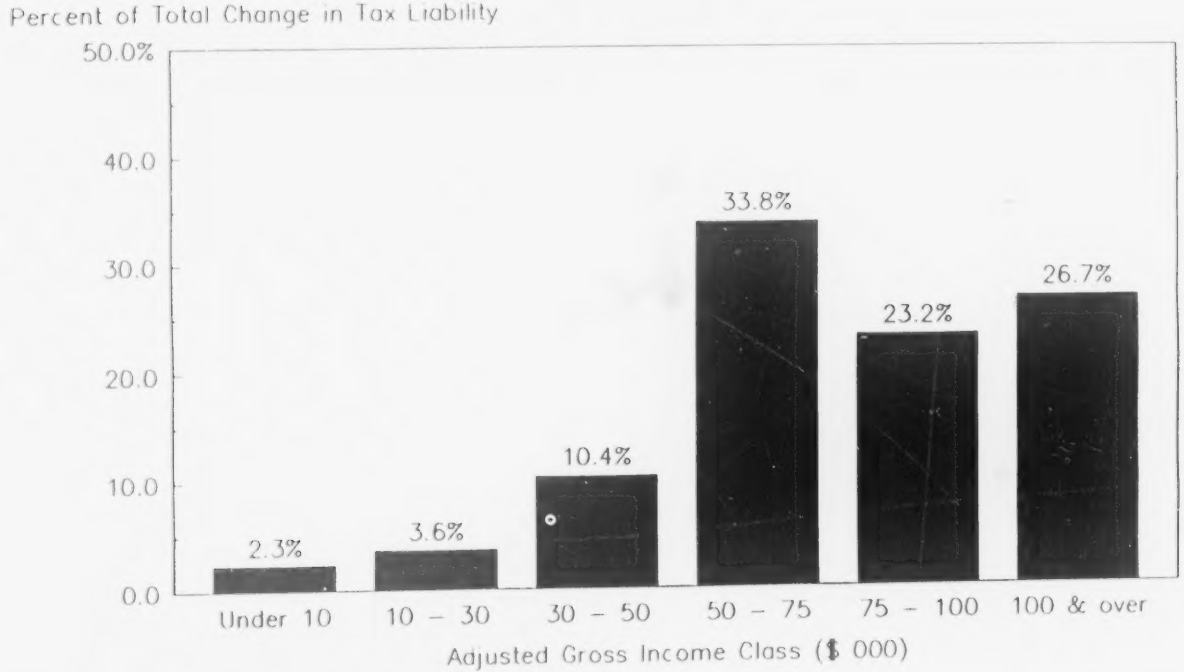
Source: U.S. Department of Commerce, Bureau of Economic Analysis, *United States National Income and Product Accounts*, table 5.1. Figures are rounded.

a. Net saving and investment equal the gross flow minus capital consumption allowances (the depreciation of existing capital). Net national product equals gross national product minus capital consumption allowances.

b. Defined as business and household saving. Employee pension funds of state and local governments are allocated to household saving to match the treatment of private pension funds.

c. Includes the statistical discrepancy added to investment side.

Distribution of Tax Reduction
Under the Bentsen IRA Proposal
1990 Levels



U.S. Department of the Treasury
Office of Tax Analysis

September 26, 1989

Exhibit 6

PREPARED STATEMENT OF SENATOR DAVE DURENBERGER

Mr. Chairman, I do not want to take very much of the Committee's time in my opening remarks this morning. But I want to raise some concerns about what I see happening as this reconciliation process continues to unfold.

Mr. Chairman, next week this Committee will begin very serious and intensive work framing what I hope will be a bipartisan reconciliation package that meets our budget goals on Medicare spending and revenue. On the revenue side, it is my hope that the Committee will continue the process begun in 1982, and repeated in 1984, 1986, and 1987, of raising revenue by broadening the income tax base. My preliminary review of the Chairman's draft reconciliation package suggests that we will continue this incremental approach to base broadening.

But I do not understand why, in a year when we are required to raise a relatively small amount of revenue—$5.3 billion, we are today considering reinstating a tax break which is sure to place severe budgetary pressures on Congress and the President in the future.

I have no doubt that IRAs are popular with nearly all of our constituents. And why shouldn't they be? All of us remember the blitz of advertising that used to take place around April 15 when the banks used to advertise IRAs as the quickest and easiest way to cut the family's tax bite. For a time, the banks even encouraged you to take out a loan to fund your SPA until Jack Danforth raised that very issue in this Committee. For many other people, especially the wealthiest citizens in our states, money was merely shifted from a taxable savings account into a tax deductible SPA. And obviously, the net effect on savings was nil.

Mr. Chairman, for as long as I have been a member of this Committee I have noted the genuine concern of all of my colleagues about the dismally low rate of savings in this country. This concern has led us to adopt measures of quite dubious value, such as All Savers Certificates and universal IRAs. Sure, the banks love such tax subsidized gimmicks, and so do our constituents. But did any of these tax subsidies really make a difference in our national savings rate? In this Senator's view, the answer is no.

There are "experts" who will come down on both sides of this issue. And I am not here to quibble with the experts. But I would note that throughout the 1980s, during the period when universal SPAs were available, and after they were cut back, this nation's savings rate was lower than in the 1950s, the 1960s, and even the 1970s. What this suggests to me is that we made the right decision in 1986 to restrict SPAS, and that we should not go back on that decision for what I see as a political reason.

Unfortunately, this entire issue will be considered against the backdrop of the debate over capital gains. This should not be an "either/or" question. As we saw yesterday in the House, the issue is not whether IRAs are better than capital gains for long-term growth. Instead, the issue seems to be which party represents the average citizen and which one represents the interests of the rich. That is just the wrong way to frame the issue.

However, if this Senator has to choose between IRAs and capital gains, I will come down on the side of capital gains. But I can flatly say that I will not support a gimmickry approach to capital gains such as is contained in the Ways and Means bill. While I know that opening a two year window for cashing in capital gains will help us meet our reconciliation goal, I believe that is a short-sighted and ill-conceived way to approach the issue.

We should be seeking to encourage *long-term* investments; not investments of 6 months or a year. If we consider capital gains, we should consider rewarding those investors who hold assets for a minimum of four or 5 years. And we should consider larger exclusions for assets held for seven to ten years.

Mr. Chairman, I think this Committee should refrain from doing anything on capital gains or SPAs this year. I know that is not a popular view, and I don't think the votes are there to hold off on these issues. But I think this Committee should take a responsible and hard look at the whole issue of how we tax capital in this country and how we tax savings in this country. Short-term responses to the problem of saving and investment in this country will not fix the problem. We need to take an overall approach to the problem on the same scale that we undertook tax reform. These are not issues that I think can or should be decided this year.

Finally, Mr. Chairman, I want to express my concern about the whole notion of reinstating tax breaks that were substantially modified or repealed during tax reform. In 1986, this Committee voted unanimously to significantly reduce the number of special tax breaks that cluttered the Code in exchange for lower marginal tax rates for all individuals and corporations. By that action, we voted to return

decision-making to the marketplace and reduce the role that government and taxes play in shaping investment decisions.

I am very concerned that if we start down the road of restoring tax breaks for this activity or that goal, the next thing we will find is that tax reform is a faded memory and low rates are sacrificed on the alter of special tax preferences. Mr. Chairman, we all worked too hard to reduce the government's role as dispenser of tax favors. Let us not begin to move back in that direction.

PREPARED STATEMENT OF SENATOR BILL ROTH

ROTH URGES BRADY TO CONSIDER THE IRA PLUS CAPITAL GAINS

WASHINGTON—"The Bush Administration can score a double victory by uniting their capital gains tax cuts with an Individual Retirement Account (IRA) for all Americans," Senator William V. Roth, Jr. R-Del., said today in urging Secretary of Treasury Nicholas Brady to seriously consider the Roth plan for an IRA Plus account.

"Why stop at the capital gains tax reduction to spark investment and economic growth? Americans want and need Individual Retirement Account," said Roth a member of the Senate Finance Committee "To many American workers, the IRA represents their greatest hope for the future. The IRA is a nest egg, security for hard-working, self-reliant men and women who are doing their best to raise families and provide greater opportunities for their children than they had themselves

"For the country, the IRA represents much needed savings for investment something we're running short on these days—but something we need to stay at the table with our strong foreign competitors.

"I have introduced a plan to give Americans both tools—the IRA as well as the capital gains tax cut," Roth said. "Implemented correctly, my IRA Plus could be used as a twin engine with the capital gains tax cut to jettison our economy into a competitive position that will serve all Americans. But both are needed. One without the other is like plowing a field, ripe for harvest, with a lame mule. You might get the job done, but no matter how hard you work, you're going to lose some of the crop."

Attachment.

SAVE AMERICA TAX ACT OF 1989

(Introduced by Senator William V. Roth, Jr., R-Del.)

FACT SHEET

The "Save America Tax Act of 1989," proposed by Senator Roth would create a new and innovative "IRA Plus" account intended to boost personal savings in the country. Unlike current IRAs, a portion of the savings in an IRA Plus account could be withdrawn without penalty before retirement for three purposes: a home purchase, education expenses and catastrophic medical expenses. The Roth proposal also includes an income credit for low-income taxpayers so they can enjoy benefits from saving.

ROTH PROPOSES "IRA PLUS" ACCOUNTS TO BOOST NATIONAL SAVINGS

IRA Plus—A new retirement account, called a "IRA Plus" is created under the bill. In general, after-tax contributions of up to $2,000 per taxpayer per year are allowed. The $2,000 limitation is increased to $3,000 after 5 years. Interest earned on the account is tax-free.

IRA Credit—IRA Plus accounts would allow a credit for low-income taxpayers. The credit is equal to 25% of the funded amount. The credit is a refundable credit so that a refund is allowed even if the credit exceeds the tax paid.

Who is Eligible—The income limitation for the credit is $18,000 for single taxpayers and $25,000 for joint filers. The credit is disallowed after age 55. For any contribution, you must have earned income at least equal to the amount of the contribution and you can count your spouse's income toward this limitation. You are eligible even if you are covered by another retirement plan. Each spouse is entitled to make a contribution, including non-employed spouses, as long as the couple's combined earned income exceeds their contribution.

Tax Free Withdrawals—There is no imposition of an income tax upon withdrawal from an IRA Plus account after age 59½. Neither interest amounts, nor amounts that received a tax credit, would be taxed upon withdrawal after that age.

No Age Limitation—Contributions can be made until death, and there is no distribution requirement at age 70½.

Premature Distributions—Except for the three exceptions listed below (home, education and health expenses), amounts withdrawn before age 59½ are subject to a 10% nondeductible excise tax. In addition, to the extent a credit was given, a "credit recapture" applies so that initial first funds withdrawn are subject to recapture. All other IRA Plus payouts are taxed as ordinary income, but no tax is due on previously taxed contributions (based on a ratio of the individual's nondeductible contributions to the total balance in the IRA Plus).

Rollover Contributions—In general, the same rollover rules apply to IRA Plus accounts as to current law IRAs. In addition, a current IRA account holder is allowed to transfer funds from his/her IRA to an IRA Plus without paying the 10% premature withdrawal penalty tax, although ordinary income taxes would have to be paid to the extent the funds represented previously deductible contributions.

Qualified Withdrawals

General Rule—Withdrawals are allowed for any of the following "qualified expenditures" without the imposition of any tax or penalty. The aggregate amount of the qualified withdrawals cannot exceed 25% of the entire IRA Plus account.

(1) Qualified Investment in a Home.—A taxpayer is allowed a withdrawal from their IRA Plus, in order to purchase a home, without incurring either the 10% distribution tax, or an income tax. If the home is later sold, the taxpayer would be subject to the 10% tax penalty and to the extent tax was deferred, would be subject to ordinary income tax. The imposition of the tax could be avoided if the plan is reimbursed for any amount withdrawn from the IRA Plus to purchase the home. The reimbursement must be made before the due date of the return for that year. If only a portion is recontributed to the plan, then the tax will be reduced accordingly.

(2) Catastrophic Medical Expenditures.—Withdrawals are permitted for qualified medical expenditures under similar rules for withdrawals from qualified retirement accounts. The IRA Plus account would not have to be reimbursed for withdrawals, but the 25% limitation above would still apply.

(3) Education.—Withdrawals would be allowed from the taxpayer's, spouse's, parent's or guardian's IRA Plus account to be used for qualified education expenses.

Educational costs would include tuition and books for accredited 2 year and 4 year degree programs for either the taxpayer, his/her spouse or their children. Multiple withdrawals would be allowed, but the withdrawals could not exceed the 25% limitation above (in aggregate).

Vesting Requirement for Withdrawals—Withdrawals under the first home, educational or health provisions above would not be allowed before a 5 year "vesting" period, measured by the first date of an IRA contribution.

Effective Date—Applies to taxable years beginning after December 31, 1989.

CHANGES IN CURRENT LAW IRAS

Spousal Limitations—A non-working spouse would not be limited to a $250 contribution. Instead, each spouse is permitted an equal deduction as long as the earned income of the couple exceeds the total contribution. In addition, if a spouse is covered by a retirement plan, then he/she would be eligible for an IRA, regardless of whether his/her spouse is eligible for an employer retirement plan.

Remaining IRA Law—remains intact.

PREPARED STATEMENT OF DALLAS L. SALISBURY

Mr. Chairman and members of the Committee, it is a pleasure to appear before you today to discuss the nation's experience with Individual Retirement Accounts.

The Employee Benefit Research Institute (EBRI) has undertaken research in this area for over a decade. EBRI is a non-profit public policy research organization located here in Washington, DC. We do not take positions on policy initiatives, but hopefully do provide research that allows others to make informed decisions.

Our most recent work on IRA's is based upon the May 1988 Census Bureau Current Population Survey Employee Benefits Supplement which was released to the public on September 15, 1989. The survey provides IRA information for tax year 1987. A similar survey taken in May 1983 for tax year 1982 allows pre and post tax reform comparisons. Further, since the survey also collected information on employment based pensions and 401(k) plans, it allows an assessment of the overall impact of tax reform on retirement savings.

The growth of 401(k) plans is relevant to an evaluation of IRA's since they have provided an alternative for pre tax deductible contributions for millions of those who "lost" the IRA with tax reform changes. As a result, a full or partial return to pre tax reform IRA rules may produce less new savings and lower revenue losses than some have argued. The 401(K)/IRA analysis has only been possible since September 15, 1989, when new government data was released.

401(k) Plan Coverage and Participation Have Grown Significantly

Over 27.5 million workers were covered by 401(k) plans in May of 1988, up from 7.1 million in May of 1983. This represented 24.2 percent and 7.1 percent of all workers respectively. Participation grew from 2.7 million workers in 1983 to 15.7 million in 1988, with the percentage growing from 2.7 percent to 13.8 percent. Coverage and participation grew significantly in both the public and private wage and salary sectors, with actual rates being higher for the public sector. Among public sector workers 19.3 percent participated, compared to 14.3 percent in the private sector.

Expansion of plan coverage and participation with before tax employee contributions was experienced at all earnings levels. More workers earning

less than $15,000 participated in plans (1.89 million) than workers earning more than $50,000 (1.86 million). The majority of participants earned less than $30,000. However, because only 4.1 million workers earned more than $50,000 the reported coverage and participation rates were higher than any other group at 56.5 percent and 45.1 percent respectively.

Passage of TRA 86 does not appear to have slowed the growth of 401(k) plans through 1988, even though the possibility remains in the future as more restrictive provisions of that law come fully into effect (e.g., hardship withdrawals, loans, early distribution penalties, etc.)

Employee 401(k) Contributions Averaged $2,000

TRA 86 placed a maximum on allowable employee contributions of $7,000 (to be indexed beginning in 1988). At the time the limit was controversial, but it appears to have been approached by very few workers in 1988. Table 1 presents average contributions for all participating workers and by earnings level, showing that the overall average was $2,000. The high was $3,500 for those earning over $50,000. The average contribution was 6.5 percent of earnings, with the greatest concentration at 6 percent, 7 percent, and 10 percent.

13 percent of all participants who reported the percentage of pay being contributed had a total contribution of less than $700; 5 percent more than $5,000. For those earning more than $50,000, 55 percent contributed $2,000 to $4,999, and 19 percent contributed over $5,000.

Three points should be emphasized. First, the average contribution of $2,000 is the IRA maximum. Second, most of those with 401(k) plans but above the IRA deductible limit could apparently have contributed more tho their 401(k) plans without exceeding tax reform limits. Third, all 401(k) contributions are deductible and for all post 1984 federal employees and over half of private workers an employer matching contribution is also provided.

Employee 401(k) Contributions May Have Exceeded $24 Billion in 1988

Using the numbers reported in the 1988 CPS EBS we estimate that employees contributed over $24 billion in 1988; $19.3 billion by private workers and $4.8 billion from public employees (Table 2).

IRA Participation Has Changed Less Than Many Predicted

The tax changes of TRA 86 reduced or eliminated allowable deductible IRA contributions for about 15 percent of the then eligible population.

Interestingly, the number of workers reporting IRA contributions dropped by 15 percent between 1982 and 1987. Table 3 shows that this decline came from all age categories and most earnings levels, possibly meaning that more than the actual tax law change was at work. Confusion, less advertising, less tax advantage due to lower tax rates, greater 401(k) availability, and other factors, may have contributed. In addition, the 1988 survey asked about contributions to an IRA, not only tax deductible contributions. It is certain that most of the nearly six hundred thousand workers earning more than $50,000 in 1987 who reported IRA contributions and pension coverage were making non-deductible after tax contributions. And, that many at lower earnings levels but above the TRA 86 income limits were as well. This indicates that the non-deductible IRA has also been more popular than many expected at the time TRA 86 was enacted. And, since published Internal Revenue Service reports on IRA use in 1987 report only deductible IRA contributions, they significantly understate total actual 1987 contributions.

IRA Users Have Changed

Between 1982 and 1987 the number of private sector workers with an IRA and an employer sponsored retirement plan declined from 23.1 percent to 15.0 percent, while the number with IRA's decreased in absolute numbers by 21 percent (from 6.8 million to 5.3 million) (Table A). As a proportion of all workers without an employer plan, IRA holders declined from 11.8 percent to 10.4 percent, but increased in absolute numbers by 7 percent from 4.0 million to 4.3 million. The distribution of those with IRA's changed by income level among both groups. The proportion of those earning more than $50,000 and having an IRA plus an employer plan dropped from 58.9 percent to 22.0 percent; among those with only an IRA from 47.1 percent to 29.1 percent. Among those earning $30,000 to $49,999 IRA use among those with employer plans declined from 32.8 percent to 17.8 percent, and among those with no employer plan from 33.4 percent to 19.8 percent.

Employment Based Plans Have The Broadest Reach

Policy debates frequently center on individual freedom of choice and the value of tax incentives for employer sponsored plans relative to incentives for individual effort. Policy debates of recent years have also focused on the concept of non-discrimination in employee benefit provision (that is,

trying to deliver benefits to the low earning worker). Table 5 provides a comparison of participation levels among the full population in all employer pension plans (42 percent), employer 401(k) plans (13.8 percent), and IRA's (12.5 percent). The table also underlines the significant growth of 401(k) plans between 1983 and 1988.

Conclusion

The data indicate that a significant percentage of those who lost the ability to make deductible IRS contributions are making non-deductible contributions and an even larger number appear to be contributing funds to 401(k) plans that were being contributed to IRAs pre tax reform. A return to pre-tax reform IRA rules is not likely, therefore, to produce either the full savings effect or the full revenue losses that have been suggested in recent weeks. A move to rules allowing a 50% deduction for a $2,000 contribution are even less likely to do so if 401(k) use is an indicator. 37 percent of those who could make a fully deductible contribution to a 401(k) plan with an employer contribution as well do not do so and few that did contribute, contributed to the tax reform maximum.

Table 1

Average Annual 401(k) Contributions[a] by Annual Earnings[b]
Private-Sector Nonagricultural Wage and Salary Workers, by Sector, May 1988

Personal Earnings	Average 401(k) Contributions[b]		
	Total	Private	Public
All workers[c]	$2,000	$2,000	$2,000
Less than $10,000	400	400	500
$10,000–19,999	1,000	900	1,000
$20,000–29,999	1,500	1,500	1,500
$30,000–49,999	2,600	2,500	2,900
$50,000 or more	3,500	3,500	3,700

Source: EBRI tabulations of the May 1988 Current Population Survey employee benefit supplement.

[a]Annual contributions were estimated by multiplying the reported contribution rate times earnings. Individual contributions for all workers reporting the necessary data were aggregated and divided by the number of workers reporting to determine the average. Averages were then rounded to the nearest $100.

[b]Annual earnings were estimated by multiplying reported weekly earnings by reported weeks normally worked per year.

[c]Includes respondents who did not report earnings.

Table 2

Aggregate Annual Employee Contributions[a] to 401(k) by Annual Earnings[b] and Sector
Nonagricultural Wage and Salary Workers, 1988

	Total	Public	Private			
		Number	Percentage	Number	Percentage	
Total	24,135	4,811	100.0%	19,324	100.0%	
$1–4,999	11	3	0.1	8	0.0	
$5,000–9,999	135	39	0.8	97	0.5	
$10,000–14,999	730	178	3.7	552	2.9	
$15,000–19,999	1,609	323	6.7	1,287	6.7	
$20,000–24,999	2,614	591	12.3	2,023	10.5	
$25,000–29,999	2,880	695	14.4	2,185	11.3	
$30,000–49,999	10,673	2,172	45.1	8,500	44.0	
$50,000 and over	5,482	811	16.9	4,671	24.2	

Source: EBRI tabulations of the May 1988 Current Population Survey employee benefit supplement.

[a]Aggregate annual contributions were estimated by multiplying the reported contribution rate for each individual times annual earnings. Individual contributions for all workers reporting the necessary data were then aggregated. Individuals who did not report earnings or contribution rates are excluded. Therefore, these estimates may be biased downward.

[b]Annual earnings were estimated by multiplying reported weekly earnings by reported weeks normally worked per year.

Table 5

Rates of Pension Participation[a], 401(k) Participation[b], May 1983 and May 1988, and IRA Participation, Tax Years 1982 and 1987, Civilian Workers Aged 16 or over, by Real Annual Earningsc (May 1988 dollars)

	Number of Workers (thousands)		Pension Participation[a] (percent)		401 (k) Participation: Percentage among All Workers		401 (k) Participation: Percentage of Workers Offered a Plan		IRA Participation[c] (percent)	
Personal Earnings	1983	1988	1983	1988	1983	1988	1983	1988	1982	1987
All Workers	98,964	113,720	42 0%	42 0%	2 7%	13 8%	38 3%	56 9%	16 9%	12 5%
$1-4,999	10,294	10,028	4 9	4 2	0 1	1 0	10 8	22 2	6 8	4 6
$5,000-9,999	13,257	13,502	16 9	17 2	0 4	3 4	16 7	32 9	8 0	7 1
$10,000-14,999	16,259	16,966	37 0	38 7	1 5	7 9	28 2	41 9	10 4	7 8
$15,000-19,999	14,052	14,700	55 0	54 0	2 8	14 2	32 1	50 5	13 4	11 3
$20,000-24,999	11,993	12,417	64 7	63 4	3 9	20 0	34 7	56 7	19 1	13 3
$25,000-29,999	6,663	8,875	72 8	71 5	4 6	23 9	40 0	58 6	21 0	17 3
$30,000-49,999	11,600	14,377	73 5	75 4	7 1	33 0	47 6	67 0	32 8	18 0
$50,000 and over	2,948	4,133	73 3	76 9	8 9	45 1	59 3	79 8	55 8	22 9

Source: EBRI tabulations of the May 1983 and May 1988 Current Population Survey employee benefits supplements.

[a]Data are for 1983 and 1988 pension and 401(k) plan participation. Pension participants in 1988 include a small number of workers who reported participation in a profit-sharing plan not identified as a pension or retirement plan. In 1983, workers who did not report participation in a pension or retirement plan were not subsequently asked about profit-sharing plan participation. Therefore, profit-sharing plans not identified as retirement plans are not reflected in 1983 estimates.

Pension participants include all workers who reported participation in a primary pension or retirement plan, even if that primary plan is a 401(k). Therefore, some workers with only one plan are reported here both as pension participants and 401(k) participants. At least 15 percent of all pension participants in 1988 participated in a primary 401(k).

Pension participants also include workers with a primary or secondary self-employed job who reported contributing to a Keogh plan the prior year. In most other EBRI work, self-employed workers with IRAs are also classified as pension participants; here they are excluded.

[b]401(k) participants include workers' 401(k) served as their primary retirement plan. In 1988, 38 percent of all 401(k) participants reported their 401(k) as a primary pension or retirement plan; these workers are reported here as both pension and 401(k) participants.

[c]Annual earnings were estimated by multiplying reported weekly earnings by reported weeks normally worked per year.

Table 4

IRA Participation by Real Annual Earnings[a] (May 1988 dollars) and Age,
Civilian Workers Aged 16 or over, 1982 and 1987[b]

	IRA Participants by Age (thousands)											
	Total[c]		25-34		35-44		45-54		55-59		60-64	
Personal Earnings	1982	1987	1982	1987	1982	1987	1982	1987	1982	1987	1982	1987
Total[d]	16,713	14,261	3,108	2,832	3,967	3,797	4,532	3,476	2,687	1,818	1,482	1,390
$1-4,999	698	464	108	84	121	76	205	68	105	65	56	64
$5,000-9,999	1,062	958	184	155	192	161	267	219	193	125	80	129
$10,000-14,999	1,692	1,328	327	305	373	289	404	317	334	163	142	141
$15,000-19,999	1,884	1,665	390	334	342	424	523	338	301	211	198	203
$20 000-24,999	2,292	1,650	514	370	536	495	587	319	336	251	203	162
$25,000-29,999	1,402	1,538	293	318	315	455	364	303	239	228	130	180
$30,000-49,999	3,804	2,589	738	600	1,148	804	1,017	727	530	273	301	119
$50,000 and over	1,646	947	162	185	465	292	554	306	308	107	112	45
	(percent distribution)											
Total[e]	100 0%	100 0%	18 8%	21 1%	24 1%	26 9%	27 1%	23 3%	16 2%	12 8%	8 4%	9 4%
$1-4,999	4 8	4 2	0 7	0 8	0 8	0 7	1 4	0 6	0 7	0 6	0 4	0 6
$5,000-9,999	7 3	8 6	1 3	1 4	1 3	1 4	1 8	2 0	1 3	1 1	0 6	1 2
$10,000-14,999	11 7	11 9	2 3	2 7	2 6	2 6	2 8	2 8	2 3	1 5	1 0	1 3
$15,000-19,999	13 0	14 9	2 7	3 0	2 4	3 8	3 6	3 0	2 1	1 9	1 4	1 8
$20,000-24,999	15 8	14 8	3 6	3 3	3 7	4 4	4 1	2 9	2 3	2 3	1 4	1 5
$25,000-29,999	9 7	13 8	2 0	2 9	2 2	4 1	2 5	2 7	1 7	2 0	0 9	1 6
$30,000-49,999	26 3	23 2	5 1	5 4	7 9	7 2	7 0	6 5	3 7	2 4	2 1	1 1
$50,000 and over	11 4	8 5	1 1	1 7	3 2	2 6	3 8	2 7	2 1	1 0	0 8	0 4

Source: EBRI tabulations of the May 1983 and May 1988 Current Population Survey employee benefit supplements

[a]Annual earnings were estimated by multiplying reported weekly earnings by reported weeks normally worked per year.
[b]Data for tax years 1982 and 1987.
[c]Total includes persons under age 25 and persons age 65 and over, not reported separately.
[d]Includes those who did not report earnings.
[e]Excludes those who did not report earnings.

Table 5

IRA Participation[a] by Pension or 401(k) Participation[b] and Real Annual Earnings[c] (May 1988 Dollars)
Private Sector Wage and Salary Workers, May 1983 and May 1988

	Pension or 401(k) Plan Participants						Workers Without Pension or 401(k) Plan					
	Number with IRA (thousands)		Percentage with IRA		Percentage among IRA Participants		Number with IRA (thousands)		Percentage with IRA		Percentage among IRA Participants	
	1982	1987	1982	1987	1982[d]	1987[d]	1982	1987	1982	1987	1982[d]	1987[d]
Total[e]	6,875	5,322	23 1%	15 0%	100 0%	100 0%	3,953	4,281	11 8%	10 4%	100 0%	100 0%
$1-4,999	52	26	17 0	9 0	0 8	0 5	277	285	4 9	4 4	8 1	8 3
$5,000-9,999	182	167	12 1	10 2	2 8	3 4	431	524	6 0	6 3	12 6	15 2
$10,000-14,999	504	474	12 0	9 5	7 9	9 5	626	569	9 1	7 2	18 3	16 5
$15,000-19,999	796	696	14 9	12 3	12 4	14 0	549	525	12 9	10 1	16 0	15 2
$20,000-24,999	1,066	726	19 2	12 5	16 6	14 6	519	469	18 9	13 6	15 2	13 6
$25,000-29,999	699	807	20 4	17 6	10 9	16 2	221	364	19 4	19 4	6 5	10 6
$30,000-49,999	2,114	1,496	32 8	17 8	33 0	30 0	634	503	33 4	19 8	18 5	14 6
$50,000 and over	992	592	58 9	22 0	15 5	11 9	168	209	47 1	29 1	4 9	6 1

Source EBRI tabulations of the May 1983 and May 1988 Current Population Survey employee benefit supplements

[a]IRA participation for tax years 1982 and 1987

[b]Data are for 1983 and 1988 pension and 401(k) plan participation. Pension participants in 1988 include a small number of workers who reported participation in a profit sharing plan not identified as a pension or retirement plan. In 1983, workers who did not report participation in a pension or retirement plan were not subsequently asked about profit sharing plan participation. Therefore, profit sharing plans not identified as retirement plans are not reflected in 1983 estimates.

Pension participants also include workers with a primary or secondary self-employed job who reported contributing to a Keogh plan the prior year. In most other EBRI work, self-employed workers with IRAs are also classified as pension participants; here they are excluded.

Workers for whom pension or 401(k) participation status could not be determined are excluded from this table.

[c]Annual earnings were estimated by multiplying reported weekly earnings by reported weeks normally worked per year.

[d]Excludes participants who did not report earnings.

[e]Total includes participants who did not report earnings except where noted.

PREPARED STATEMENT OF GEORGE R. SHAFFER

Mr. Chairman, my name is George Shaffer, and I am president of the Insurance Center in Albuquerque, New Mexico and chairman of the Government Affairs Committee for the Independent Insurance Agents of America. I appreciate the opportunity to testify on the Bentsen IRA proposal today.

It's no secret that foreign capital helps to keep our economy afloat, and it's no secret that unabated consumerism has stifled savings in this country. For many years the tax code has favored debt financing and consumption, while discouraging savings and capital formation.

The IIAA believes the Bentsen IRA proposal is a major step in the right direction—one that will help rectify the dismal national savings rate, which is lower than all our major international competitors. Economists have forewarned us of the dangers of low savings rates and while IRAs may not be the single answer for our low savings rate, they will make a significant difference. After the 1986 Tax Reform Act, contributions to IRAs declined by approximately $25 billion, a cut back of nearly 62 percent. Even after factoring in a shifting of savings, these statistics do not bode well for our GNP and international competitiveness.

IIAA believes the Bentsen IRA proposal will make American business more competitive in general, and the insurance industry in particular. As independent agents, we are uniquely situated in the small business community and in the insurance industry—one of the most interest rate sensitive industries in the nation. The Chairman's proposal should help to lower interest rates, a benefit for small business, but a result that could make the insurance industry more competitive on an international basis and ultimately benefit American insurance consumers.

The property-casualty insurance industry is known for its cyclical business trends, which bear a direct correlation to interest rates. A contributing factor that led to the last hard insurance market was cash flow underwriting, an insurance company practice that was exacerbated by high interest rates. Low and stable interest rates would certainly help put the brakes on the cyclical nature of the property-casualty industry, which we believe would ultimately help the consumer. Lower interest rates would also allow for further overseas expansion by insurance companies, something that will become increasingly important in Europe in 1992.

The unprecedented economic growth of our country over the last 9 years has been good news for the business community, but there are signs both in the insurance marketplace and the economy in general that cause small business owners concern. Both our monetary and fiscal policies must be in sync to reduce interest rates if we are to remain competitive in domestic and world markets.

In addition to the macro economic benefits of IRAs for the U.S. economy and the insurance industry, they will definitely benefit the average American family. I can personally attest that IRAs as a savings vehicle for college education would be an invaluable incentive for many families. Even though many independent agents have Keoghs, we believe IRAs would be widely used as vehicles for additional savings, surely for retirement but also for the added benefits, especially penalty-free IRA withdrawals for higher education expenses.

IIAA agrees with Jonathan Skinner, a University of Virginia economist who found through empirical evidence that IRAs represent new savings. Granted, some will shuffle assets out of taxable accounts and into IRAs, but we believe many small business owners including independent agents, will simply add $2,000 in savings to an IRA, without shifting their funds from taxable vehicles.

Mr. Chairman, there are many areas of the tax code that need further improvement, but the Bentsen IRA proposal, by creating incentives to save and at the same time providing options for some of life's necessities, helps keep our nation competitive in the rapidly changing international marketplace and it will be a boon to American families.

PREPARED STATEMENT OF JONATHAN SKINNER

Good morning Mr. Chairman and members of the Committee. My name is Jonathan Skinner, and I am Associate Professor of Economics at the University of Virginia and Research Associate at the National Bureau of Economic Research. My research focuses on why people save, and in particular the effect of taxation on saving.

I am pleased that Individual Retirement Accounts (IRAs) are reemerging as a national program to augment both the income security of the elderly and the economic growth of the United States.

The national saving rate in the United States is among the lowest in the industrialized world. In part this is caused by government deficit spending, but the American citizen must share the blame as well. Personal saving rates of households fell from an average of 7 cents per dollar of income during the 1960s to an average of only 4 cents per dollar since 1985.

Congress eased enrollment requirements for IRAs in 1982 to encourage national savings. The program enjoyed tremendous success; by 1986 new contributions were $38 billion. But tightened rules in the Tax Reform Act of 1986 cut back enrollment substantially; by 1987, new contributions had fallen to only $14 billion, a decline of 62 percent.

Why were IRAs nearly written out of existence in the 1986 Tax Reform Act? The backlash against IRAs reflected a widely held and I believe, incorrect—view in Washington that IRAs provided no new saving, just a tax windfall to the wealthy. The concern at the time was that a taxpayer could shuffle $2,000 from his taxable saving account into an IRA and deduct the $2000 from income on his tax return, with no increase in private saving. Even worse, a taxpayer could borrow the $2,000 for his IRA, take the tax deduction, and deduct the interest paid on the loan!

Since 1986, there has been a shift in many economists' views of IRAs. In pioneering work, Steven Venti of Dartmouth College and David Wise of Harvard University used a consumer finance survey to estimate whether IRAs were drawn from new saving (out of consumption) or from old saving (shuffling). They found that only 8 cents of every dollar were shuffled from previous saving. Of the remaining 92 cents, 57 cents were withdrawn from consumption, and 35 cents from a reduction in taxes. That is, they suggested that only 8 cents of every IRA dollar was old saving, while the remainder was new saving. These results have largely been confirmed in studies by R. Glenn Hubbard of Columbia University and others.

In a recent study, written with Daniel Feenberg of the National Bureau of Economic Research, I used a sample of 3,900 IRS tax returns between 1980 and 1984 to test whether IRAs were new saving.[1] Initially, we set out to disprove the Venti and Wise results—we thought at the time that IRAs were just shuffled saving. We expected to find that taxpayers who opened IRAs during 1982–84 gradually removed assets from taxable accounts and put them into IRAs. The "smoking gun" we looked for was a decline in reported interest and dividend income as the taxable deposits were shuffled into IRAs. To our surprise, we found exactly the opposite. Taxpayers who purchased IRAs during each of the years 1982–84 tended to increase their *taxable* saving by far more than those who did not purchase IRAs. Rather than disproving the Venti and Wise studies, we confirmed them.

We were still skeptical, so we ran more tests. Suppose there are two kinds of families in our sample. The thrifty households shuffle the first $4000 of savings into IRAs, and deposit the rest into taxable money market accounts. The profligate households neither save nor open an IRA. Mixing the two types of households in our sample, we would find that families with IRAs saved more (the thrifty families), while the families without IRAs would save less (the profligate families). This might lead us to mistakenly conclude that IRAs led to new saving. So we tried to develop a better test that was not subject to this objection. We figured that financial wealth in 1981, before IRAs were widely introduced, would be a good indicator of thriftiness. We therefore compared families with the same initial wealth, and found that our results still held.[2]

One puzzling question remains: why should IRA enrollees go on saving binges? Recall that advertisements for IRAs were widely distributed during the mid-1980s. They promised to make you a millionaire by the time you retired if you made an annual $2,000 contribution. And in fact, our study found that one-third of all enrollees did contribute exactly $2,000, even when they were eligible to contribute up to $4,000! Why $2,000? We interpret this to mean that the marketing blitz was effective at conveying both correct information—that IRAs were a good investment—and incorrect information—that the upper limit was only $2,000.

One strong predictor of IRA enrollment was whether the taxpayer owed money to the IRS on April 14th. We interpret this to mean that a taxpayer in a 40 percent bracket preferred to open a $2,000 saving account than write an $800 check to the IRS. The instant gratification of deducting IRA contributions both increased the

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[1] "Sources of IRA Saving," in Lawrence Summers (ed.) *Tax Policy and the Economy* 3. Cambridge: The MIT Press (1989).

[2] The positive correlation between IRA purchases and taxable saving was not strong among the very wealthy with asset wealth in excess of $50,000. This may have been caused by the small size of the sample, and by the relative unimportance of IRAs in total wealth for this group.

popularity of the program, and overcame any shortsighted bias for consumption over saving.

Some recent proposals, such as the IRA-Plus, do not provide a current tax deduction, but instead "back end" the deduction by allowing the contributor to withdraw interest plus principal with no tax liability. It is my view that "back end" IRAs, while less costly in terms of current revenue, will not gain the same popularity with the taxpaying public as the original IRA. I think that taxpayers are more likely to respond to the joy of denying the IRS its due—of getting a tax shelter just like the big investors—than to the prospect of a tax break 20 or 30 years down the road.

I have two more comments about "back end" IRAs. First, I personally would be nervous about buying one, because some less responsible Congress in the future might decide to place a tax on the withdrawals after all. It is much more difficult to take back a deduction already given. Second, "back end" IRAs are available today, for almost any taxpayer. One can still contribute after-tax dollars to IRAs, even with income above $50,000. My impression is that these have not been particularly popular.

The revenue cost of IRAs looms large in political debates. It should be remembered, however, that the tax not collected from the conventional IRA is deferred, and not lost forever. Of course, future tax revenue may hold less appeal to the members of this committee who must face yearly Gramm-Rudman limits. But future tax payments from the existing pool of IRA assets represent a valuable source of future revenue. The estimated $350 billion in current IRA wealth (calculated by the Employee Benefits Research Institute as of December 1988) represents $70 billion in future tax revenue at a conservative 20 percent marginal tax rate. By contrast, plans such as the IRA-Plus collect the revenue up front at the expense of future tax collections.

Our study also suggests that once hooked on IRAs, taxpayers stay hooked. Dropout rates from IRA contributions were low; of those who bought an IRA in 1982, 75 percent continued to buy IRAs in both 1983 and 1984. The IRA program is useful in getting taxpayers accustomed to saving for retirement.

The new proposals for IRAs differ substantially from the pre-1986 IRAs because they allow contributors to take their money out for first-time housing purchases or educational expenses. Expanding IRAs in this way will increase their popularity by bringing in families too concerned with first-time home purchases or college tuition even to think about retirement saving. On the other hand, it will also make shuffling more tempting, since it will be easier to get the money out of the IRA in the short term. But short term shuffling will not be as costly in revenue terms as long term shuffling, since the taxpayer will pay back the deferred taxes in just a few years. Yet I have two concerns with opening up IRAs for education and housing. The first is that the government is potentially encouraging housing and education expenditures over long-term retirement saving. The second is that an expanded IRA may be the subject of tax abuse, since the opportunities to beat the system have increased. Just as an example, families could shelter a substantial amount of income by opening an IRA for each of their children.

Expanding IRAs have been considered as an alternative to lowering the capital gains tax rate. In my view, the expansion of IRAs is a more effective and equitable method for encouraging long-term saving. In particular, the current capital gains proposal reduces the top marginal rate to roughly 20 percent, with a transition in future years to an inflation-indexed capital gains tax. While I favor some adjustment for inflation, I do not favor a short-term reduction in capital tax, which is effectively tossing a safety net to the truly wealthy. Consider a wealthy investor who unlocks $100,000 in 1991 because of the low capital gains tax. Should he reinvest it at relatively high future capital gains rates, or should he spend it on a big-ticket consumption item? I think he'd be tempted to spend it.

IRAs cannot be viewed as the single cure for the nation's low saving rate; alone, they will not lead to savings rates equal to Japan's. Increasing the national saving rate requires a coordinated effort to cut back on the government deficit, encourage business saving, and stimulate household saving. In 1986, IRA saving (which includes both new contributions and accumulated interest) accounted for 54 cents of every household dollar saved. I therefore believe that IRAs are an effective method for encouraging household saving. In short, Mr. Chairman and members of the Committee, IRAs are a tempting carrot which, when enjoyed by the taxpaying public, can increase national saving, spur investment, and encourage long-term economic growth.

PREPARED STATEMENT OF LAWRENCE H. SUMMERS

My name is Lawrence H. Summers. I am a professor of economics at Harvard University and a research associate of the National Bureau of Economic Research, where a large part of my work is focused on issues relating to tax policy, saving and American competitiveness. I am grateful for this opportunity to address the question of how tax incentives can best be used to increase American national saving and to promote economic growth.

In my testimony today, I will make four points. First, increases in the national saving rate are imperative if the American economy is to continue growing stably and rapidly. Without increases in the saving rate, efforts to get firms to take the long view, to increase investment, or to reduce the trade deficit are unlikely to succeed. Both budget deficit reduction and reforms in structural tax policy can make an important contribution to increasing national saving.

Second, logic and evidence suggest that the restoration of IRA benefits would make a significant contribution to raising the personal saving rate. *A large fraction of IRA contributions represent new, incremental saving.* It is likely that new saving spawned by extending IRA benefits would exceed revenue losses to the Treasury.

Third, Increases in IRA's are preferable to temporary reductions in capital gains taxes as vehicles for spurring saving, investment, and economic growth:

—IRA's reward new saving. A temporary capital gains cut would encourage consumption by promoting financial engineering and the sale of assets. It would provide only very marginal incentives for long term investment and do nothing to increase national saving.

—The near term budgetary costs of IRAs far exceeds the long term cost, whereas capital gains reform is a long term disaster for the budget.

—Prior to its partial repeal in 1986, the IRA incentive was having a significant effect on the behavior of middle class Americans. Capital gains reductions largely benefit persons in the top 1% of the income distribution. They would do little to changed the saving habits of most Americans.

Fourth, there is room for technical improvement in both the capital gains and IRA legislation now being considered. If they are too be granted, capital gains reductions should be given only on future gains, and should be targeted to promote venture capital and to avoid creating tax shelter opportunities. It would be desirable for IRs to contain a "backend deduction option." This would smooth out their budgetary impact, and increase their effectiveness as a saving incentive.

THE IMPORTANCE OF INCREASING NATIONAL SAVING

As a nation, we consumed publicly and privately more than 97 cents out of every dollar of income we earned over the last several years. Our current national saving rate is one-third of the rate we enjoyed during the 1970s, when supply side concerns about inadequate saving began to emerge. As Figure I, prepared by the Congressional Budget Office indicates, during the 1980s, the United States national saving rate is less than half of the average saving rate of major industrialized countries and about 1/5 of the saving rate of Japan.

Low national saving means slow growth in American living standards and reduced American competitiveness. It is the primary cause of our current trade deficit. Nations like the United States that invest more than they save must borrow funds from abroad. The only way foreign funds can cone into the United States is for Americans to import more than they export. The US current account deficit-of 3.5 percent of CNP in 1987 arose because the United States saved only 2 percent of CNP but invested 5.5 percezjt of GNP. Japan, on the other hand with saving in excess of investment has enjoyed consistent trade surpluses.

Low national saving also results in low investment. The United States invested less, relative to CNP in plant and equipment during the 1980s than during the 1950s, 1960s, or 1970s. Capital labor ratios have grown less rapidly in the United States than in any of our major competitor nations with disastrous consequences for living standards. Japanese workers have gained ground at 6% a year relative to their American counterparts over the last 15 years as American real wages and family incomes have remained essentially stagnant.

Low national saving leads to reduced investment because it *raises the cost of capital* by making it scarce. High costs of capital are an important explanation for the myopia often thought to afflict American businessmen. An American businessman, given his costs of capital would be willing to invest only $.37 in return for a dollar 6 years from now, compared with $.66 for his Japanese counterpart. It is hardly sur-

prising that Japanese managers often appear to take a longer view than their American counterparts.

The combined effect of reduced investment and the foreign financing of a large fraction of what investment does take place is to gradually reduce relative American living standards. This is not something that occurs overnight but as Figure 2 illustrates, there is a clear relationship between national saving rates and rates of growth. The United States is a wealthy nation and so it can finance a high rate consumption by selling off assets for a long time-but not for ever. Unless, our national saving rate is restored at least to its former level in the 7 percent range it is very likely that we will be overtaken by a number of our competitor nations in the next few years.

Without increased national saving it will be impossible to simultaneously increase investment and reduce the trade deficit and America's dependence on foreign capital regardless of what investment incentives are provided or what trade policies are pursued. As a matter of arithmetic, domestic investment can only be financed from domestic saving or from foreign borrowing. Without increases in saving, any increase in investment must come from increased foreign borrowing which means a larger trade deficit. Conversely, any reduction in the trade deficit caused by a change in exchange rates or trade policies reduces the supply of capital to American firms dollar for dollar raising capital costs and choking off investment. Only by raising our national saving rate is it possible to reconcile the goals of increasing investment and reducing the trade deficit.

As is now widely recognized, sustained reductions in the Federal budget deficit are the most potent and reliable way to increase national saving. By reducing public dissaving, reductions in Federal deficits raise national saving almost dollar for dollar. However, to be successful policies must lead to sustained reductions in the deficit. Just as government asset sales reduce the current year budget deficit, but do little to increase saving since they reduce the government's subsequent income, *tax measures which raise revenue primarily by accelerating collections do not make a genuine contribution to increasing national saving.* This is why it is critical that the Congress carefully consider the long term budgetary consequences of any tax policies it enacts.

IRAS ARE AN EFFECTIVE SAVING INCENTIVE

While the 1986 Tax Reform Act increased economic efficiency in many ways, the partial revocation of IRA's was unfortunate because the conviction that IRA's are ineffective in stimulating savings is not supported by the available evidence. While the officially measured personal savings rate has declined since 1981, this should not be taken as evidence that IRAsdo not have a substantial impact on savings decisions. Many other factors affecting the savings rate have changed since 1981, so that any positive effect IRA's might have had has been masked. Reduced corporate pension contributions, increased consumer borrowing, and renewed consumer confidence are all possible explanations for the low savings rate. Without the enactment of IRs, the savings rate might well have fallen even further. In fact, IRA contributions accounted for more than ¼ of all personal saving in 1986.

While naive before and after comparisons do not shed much light on the incentive effects of IRAs, other evidence strongly suggests that they have a significant impact on savings. Perhaps the most direct evidence on the question of whether IRA savings represent incremental savings comes from direct surveys of savers. Respondents in the Federal Reserve's Survey of Consumer Finances were asked wither they made IRA contributions and a variety of other questions about their financial affairs. David Wise of Harvard's Kennedy School of Government and Steven Venti of Dartmouth College have conducted a careful statistical analysis of these data on the basis of which they conclude that about half of the money flowing into IRA's represents new savings, about thirty percent of the money comes from the taxes individuals save by making IRA contributions, and only about 20 percent of the money comes from savings that would have taken place anyway had their been no IRAs.

Other evidence also refutes the claim that most IRA contributions come from reshuffling assets. First, the Consumer Expenditure Survey indicates that the median IRA contributor had only $8,000 in fully liquid assets in 1985. For a married couple, this is only 2 years' IRA contribution. The available data also suggest that most IRA contributors have very little interest and dividend income. It seems unlikely that people with modest asset holdings could finance IRA contributions by reshuffling for very long. Indeed, it is ironic that IRAs were scaled back just at the time when their effectiveness in stimulating new saving should have increased.

Second, nearly two-thirds of IRA contributors do not make the maximum possible contribution suggesting that they cannot effortless move money in order to contrib-

ute. reflects the reshuffling of assets rather Further evidence that many IRA contributions represent incremental savings is provided by the behavior of IRA contributors.

Third, the timing of IRA contributions is suggestive. An individual can maximize his tax advantage from making use of an IRA by contributing as early as possible, in January of each tax year. Presumably taxpayers who were simply shifting assets that were being saved anyway would make their IRA contributions early in the tax year. On the other hand, persons for whom IRA contributions represent new savings may not have funds on hand to contribute early in the tax year. IRS statistics reveal that some $15 billion or 45 percent of 1984 IRA contributions were actually made in 1985 suggesting that a significant amount of new savings were generated by IRA contributions. It is striking that holding everything else constant individuals are more likely to make an IRA contribution if they owe taxes in April than if they expect to receive a refund.

More important than the question of whether IRA saving is financed out of borrowing or other saving is the broader effect of IRAs on attitudes for saving. Given our national saving problem, it is unfortunate that polls reveal that many Americans regard increasing saving as bad for the economy because it reduces the demand for goods. IRAs and the advertising they generate are a useful counterbalance to this sentiment. *It may well be that saving like life insurance is sold not bought.* The existence of IRAs may cause people to focus more on the need to save for their retirement than they otherwise would. They certainly give banks and other financial institutions a strong incentive to remind people of the need to save for retirement.

Unfortunately since the partial repeal of IRAs in 1986, this incentive has dwindled. A top executive of one very large New York banks indicated to me that his bank had reduced its IRA advertising budget from $23 million to less than $10 million following the 1986 Act, and intended to reduce its budget further if the law was not changed. This is not atypical. Press reports suggest that many other financial institutions abandoned IRA advertising once the potential market was reduced following the 1986 Act. There is evidence that advertising reductions mattered. *Even among those who remained eligible following the 1986 Act, the take-up rate for IRAs appears to have declined sharply in 1987.* Moreover, despite their being attractive for many high income taxpayers, non-deductible IRAs have not been popular.

International experience confirms the view that saving incentives matter. Most of the nations we compete with have higher saving rates than the United States. As Table 1 suggests, most also have more generous saving incentive programs. Especially dramatic evidence of the long term importance of the hortatory effects of saving incentives comes from Canada which put a retirement savings program like our IRA program into effect in 1972 and significantly liberalized it in 1976. As Figure 3 illustrates, the savings rate in Canada which had closely tracked that of the United States took off soon after the 1976 liberalization and has exceeded ours ever since.

The weight of the available evidence suggests that IRAs generate a significant amount of saving that would not otherwise have taken place. Under current law, if IRAs were reinstated, the government would lose about 25 cents for each dollar of contribution. If more than one fourth of the money contributed to IRAs represents new savings, they will increase private savings by more than their revenue cost. If this condition is met, the case for reinstating IRAs is clear. Even if it is not, there is still a strong case for savings incentives given that restoration of IRAs would be likely to come at the expense of other tax breaks rather than larger deficits. While hard statistical evidence is not available I believe that IRAs could be made more attractive by permitting their use to finance new homes and education as well as retirement. This would make them much more attractive to young earners.

IRAS VS. CAPITAL GAINS

The Congress is now considering partial restoration of IRAs and a temporary capital gains rate reduction followed by capital gains indexation as alternative reform options. I believe that IRAs are far preferable to capital gains reductions for a number of reasons. Enacting a temporary capital gains measure would be a definite mistake that would damage the economy for some years to come.

First, while as I have just argued IRAs contribute new saving to the economy, *a temporary capital gains cut would actually reduce saving and increase consumption.* A two year capital gains holiday would encourage those who have accrued them in the past to realize gains by selling assets. Ironically it would make investors less rather than more patient. With their assets "unlocked" there would be some tendency for sellers to spend some of their proceeds. Moreover, a capital gains holiday will accelerate financial engineering directed at reducing corporate saving. If the

President's capital gains proposal had been in place, the government's tax take from the RJR-Nabisco deal alone would have fallen by more than $1 billion.

Second, IRAs by increasing the pool of American saving raise the supply of capital and lower interest rates thereby encouraging long term investments. On the other hand, most of the benefits of capital gains cuts go to those who have already accrued gains. Not even the most zealous supply sider can believe that incentives can create more old capital. Much of the remaining benefit goes to investors whose horizon is short, and who plan to sell out before the end of 1991. A capital gains cut is also very poorly targeted towards its objectives. Corporate assets account for less than ⅓ of capital gains and venture capital accounts for less than 2 percent.

Third, *while IRAs help the long term budget, capital gains are a budgetary disaster.* IRAs permit taxpayers to postpone tax liabilities not eliminate them altogether. When individuals eventually withdraw their money from an IRA, the government recoups with interest the tax revenues foregone when the IRA contribution was made. In this sense, the one or two year budget numbers overstate the real cost of restoring IRAs.

On the other hand, a temporary capital gains rate cut would exacerbate the long run deficit problem by tens of billions over the next decade. The revenue gains from a capital gains tax holiday come at the expense of future tax collections as individuals realize capital gains more quickly than they otherwise would have. In effect, a capital gains holiday is simply a device for inducing individuals to prepay their tax liabilities. It is the moral and economic equivalent of using asset sales as a deficit reduction device. In both cases, subsequent revenues are sacrificed for a one-time budgetary improvement.

Because reducing the deficit through a capital gains holiday or similar gimmick is just a backdoor way of borrowing from taxpayers, it achieves none of the economic goals of deficit reduction. Economists are often pedantic on the point that it is national saving not the government's deficit that is the real area of concern. But here is a case where exactly this distinction matters. A capital gains holiday would temporarily reduce the government's deficit but it would neither make room for increased investment nor reduce our dependence on foreign capital.

Deficit reduction can only have these beneficial effects if it reduces either private or public consumption. But a capital gains holiday is obviously not going to reduce public spending. And it is hard to see how a purely voluntary tax reduction opportunity that causes individuals to cash out their currently locked in gains will do anything other than increase their consumption. As a result, even if it did reduce the deficit, a capital gains holiday would actually serve to crowd out investment and to increase our rate of foreign borrowing.

Fourth, IRAs stimulate saving by the broad middle class. IRS data suggest that only 1 in 3 American families consistently have more than $1,000 in income earning assets. Most of the benefits of expanded IRAs would go to middle class families that now do relatively little saving. On the other hand, the benefits of capital gains cuts would accrue largely to high income taxpayers. Efforts to claim otherwise by pointing to the low wage and salary income of persons who live by clipping coupons and selling off assets are deceptive. Close to ⅔ of the benefits of a capital gains rate reduction would flow to persons with an income of over $200,000.

IRAs directly attack the problem of inadequate saving whereas capital gains tax reform targets investment. Without increased domestic saving stimulus to investment even if is provided means increased foreign borrowing and a larger trade deficit. This does not seem desirable.

AMENDING THE PROPOSALS

I believe that an IRA option is much better than a capital gain option as a vehicle for increasing saving and promoting economic growth. However, I believe that the IRA alternative currently under discussion could be improved. Most importantly, a back-end deduction should be provided as an option for taxpayers who prefer to contribute after tax dollars. This option would be attractive to some taxpayers, for example those who expect tax rates to rise rapidly in the future, but not to all. To the extent that it was taken up, it would reduce the near term budget cost of an IRA proposal. It would also increase the stimulus to saving.

While the backend approach is a useful complement to the restoration of IRAs, it is not a satisfactory substitute. In many cases, the decision to contribute to an IRA is stimulated by the alternative of paying taxes to the government. This is why the receipt or non-receipt of a refund is an important variable explaining IRA participation. As experience since 1986 suggests, IRAs lose much of their appeal if the tax advantages are deferred. It would probably be a mistake to enact an IRA program that did not give tax payers some up-front deductibility of their contributions.

Other options worthy of consideration include permitting borrowing against one's IRA to meet health expenses. Consideration should also be given to ways of inducing employers to sell their employees on IRAs. This might be done by allowing some deductibility of IR contributions against payroll taxes.

—If capital gains taxes are to be reformed, the reform should achieve the objective of spurring productive new investment. In order to be viable in the current deficit environment, any capital gains proposal has to be at least a small revenue raiser over the next several years.

Here is a plan that achieves both these objectives. The tax law should be changed to reduce the capital gains tax rate to 20 percent on all assets purchased after January 1, 1990. All assets purchased prior to January 1, 1990 would be taxed at current capital gains tax rates. At any time they wished individuals could realize the capital gain on assets they already held, pay taxes on the proceeds at current rates, and from that point forward be taxed on subsequent gains at the 20 percent rate. Depending on policymakers preferences (and political reality) this proposal could be applied to all assets or only to certain categories of assets so as to exclude collectibles or real estate.

This proposal should be supported by those concerned with incentives, income distribution, and with revenue. Incentive oriented reformers should see that as far as future investments go, which are the only kind that changes in the tax code can affect, this proposal is every bit as good as an across the board capital gains rate cut. Distributionally oriented reformers should prefer this form of capital gains tax reform to others because it does not confer any windfall on those who have made and profited from investments in the past, and focuses only on future investors. And revenue oriented reformers should take heart from the fact that rate reduction will not cost much over the next few years because it will only apply to gains earned after January 1990. Its cost will certainly be more than offset by revenue gains as individuals realize capital gains in order to qualify for the 20 percent rate on subsequent gains.

One objection to this scheme is that individuals might be reluctant to sell their assets in order to qualify for the 20 percent rate because the fear that it would be rescinded by some future Congress. Even if this fear is legitimate, it serves only to reduce the short run revenue gain from the proposal. Furthermore, by explicitly establishing a class of qualifying assets on which gains would be taxed at a 20 percent rate, regardless of what was done to subsequent investments, Congress could make it very difficult for itself to change the rules ex-post. It is noteworthy that Congress has never come close to changing depreciation rules on an ex-post basis, even in years like 1986 when the rules applying to new assets were made substantially less favorable to taxpayers.

The approach suggested here could obviously be amended to address various specific concerns. Although, I believe that indexing capital gains without indexing the rest of the tax system would create more distortion than it would eliminate as well as serving to attenuate the social pressure which tends to keep inflation down, indexing could be applied to assets purchased after January 1, 1990. It would also be possible and probably desirable to limit the benefits of the 20% rate to those holding their assets for more than some minimum holding period. What is crucial is this principle: *Any capital gains break should apply only to taxpayers who realize and pay taxes on the capital gains they have already accrued.*

This principle is accepted in the legislation that Senator Bumpers and a number of co-sponsors have introduced. The Bumpers bill also reduces budgetary costs and avoids abuses by targeting relief on new small businesses. If capital gains taxes are to be reformed, it is an excellent option.

TABLE 1.—SAVING INCENTIVES: AN INTERNATIONAL PERSPECTIVE

Many industrialized nations offer tax incentives for saving by their citizens. Some examples:

BELGIUM: Income from savings bank deposits is deductible up to a limit ($US 800 in 1987)

CANADA: Up to $US 750 of investment income is tax free. Savings in Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs) is tax deductible up to a limit ($US 2640 in 1987). In addition, the income earned accumulates free of tax.

FINLAND: All interest from bank deposits and government bonds is tax deductible.

FRANCE: Income from bonds and from shares is deductible up to a limit ($830 and $500 respectively in 1987). Net purchases of shares are deductible up to a limit ($830 in 1987) There is a flat-rate withholding tax on investments, rather than the steeper income tax rates.

GERMANY: Income from capital is exempt from taxation up to a limit ($440/couple in 1987).

ITALY: Interest from government bonds is tax deductible. Nondividend returns are subject to a flat-rate withholding tax.

JAPAN: Prior to 1987, interest on bank deposits, public bonds, mortgaged debentures, stock investment trusts, postal savings, and government bonds was deductible up to very high limits. Interest income or distribution of profits from employee savings accounts is deductible if used for housing or pension purposes (up to $35,000 in 1987).

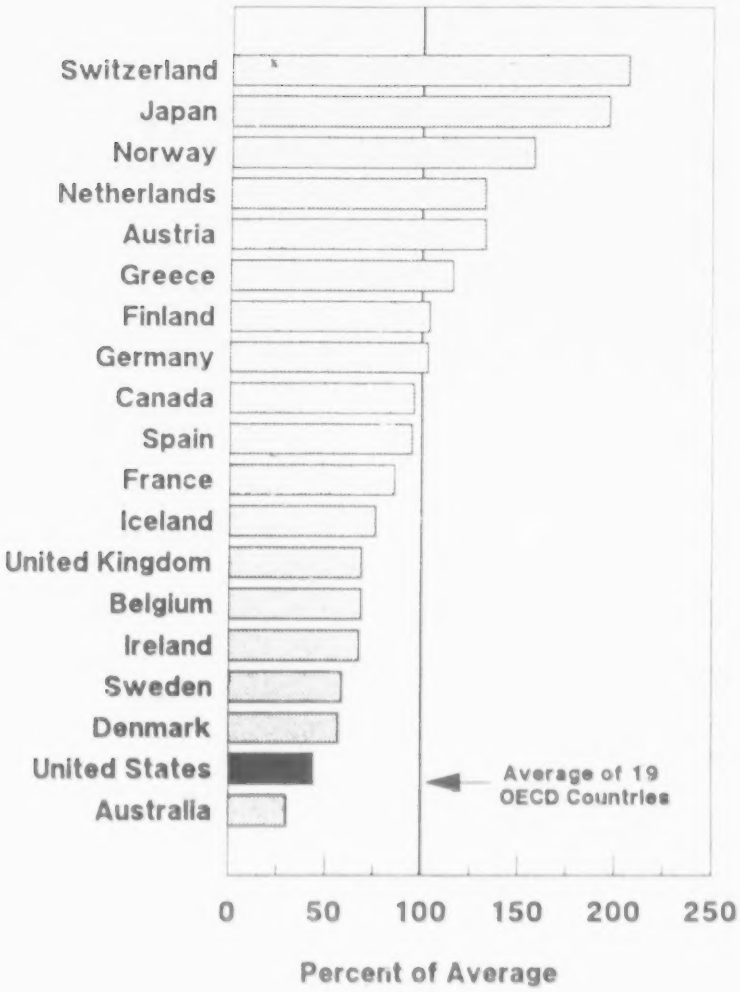
NETHERLANDS: Interest received is deductible up to a limit ($690 in 1987). Dividends received are tax free up to a limit ($990 in 1987).

NORWAY: Interest and dividend income is tax free up to a limit ($600/couple in 1987). Investment in special bank plans and in shares is tax deductible up to a limit ($1190/couple and $600/couple respectively in 1987).

SWEDEN: Income from capital is deductible up to a limit ($250/couple in 1987). Certain savings accounts accumulate tax-free (limit on deposits of $1500/year in 1987).

Attachments.

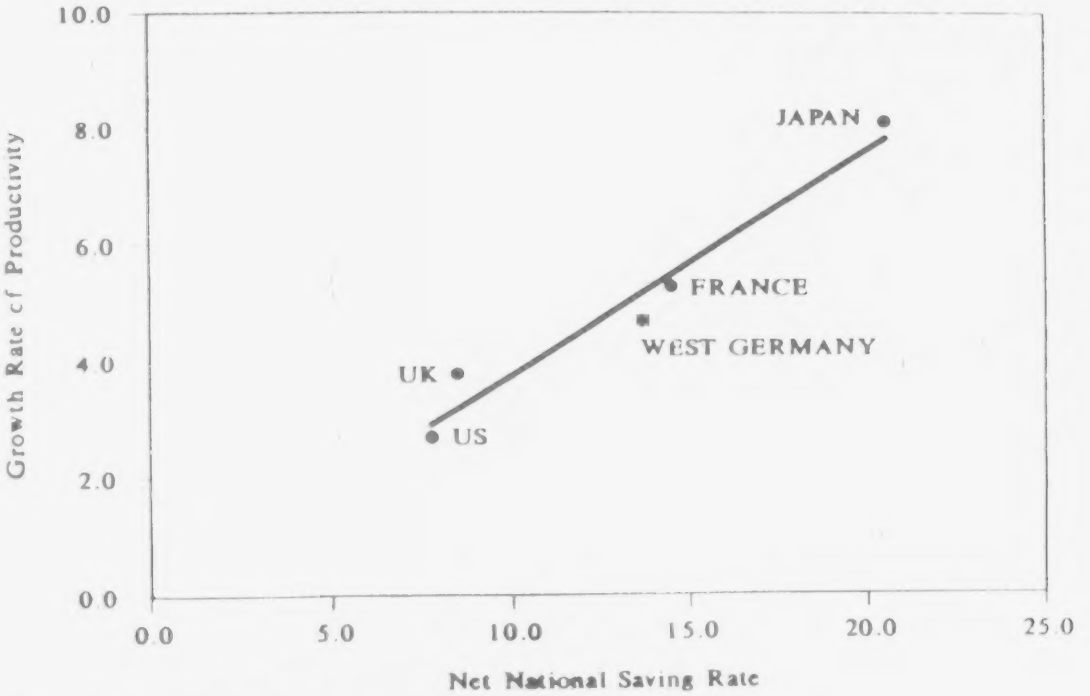
FIGURE 1. NET NATIONAL SAVING, 1980-1986



SOURCE: Congressional Budget Office calculations based on data from the Organisation for Economic Cooperation and Development.

FIGURE 2

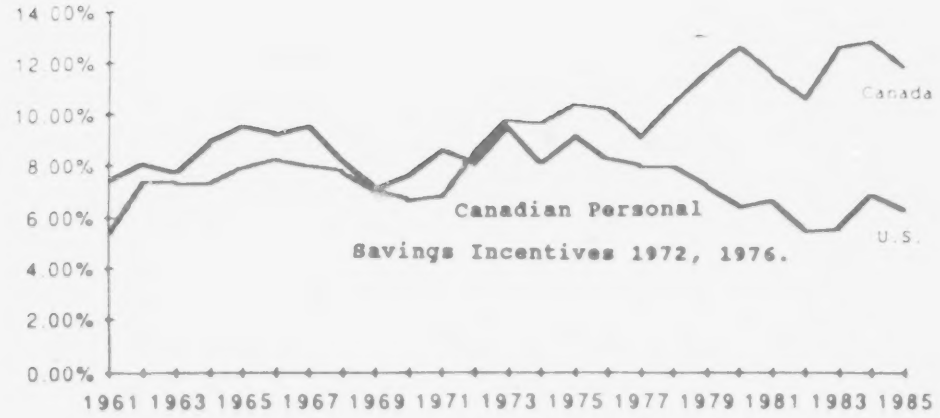
MANUFACTURING PRODUCTIVITY GROWTH VS. NET NATIONAL SAVING
(AVERAGE ANNUAL PERCENT, 1962-1985)

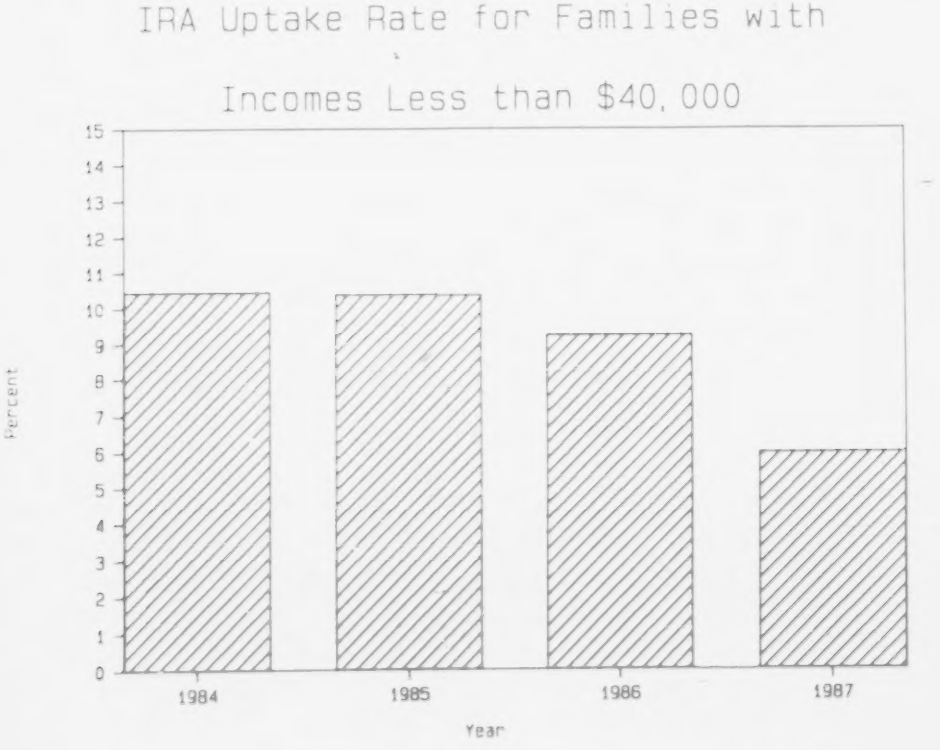


Sources: U.S. Department of Labor, Bureau of Labor Statistics
Organization for Economic Cooperation and Development

FIGURE 3

Total Private Saving as a Percentage of GNP





PREPARED STATEMENT OF JULIANNE STILL THRIFT

Mr. Chairman and Members of the Committee: I am Julianne Still Thrift, executive vice president of the National Association of Independent Colleges and Universities (NAICU) which represents more than 830 private colleges and universities. I am here today to address the important role that Federal incentives play in a family's decision to save for college, and the concerns colleges and universities share with parents and students about the increasing costs of higher education. I also have two children, and like any other parent in America, I worry about how I will pay for their college educations.

First, I would like to commend Senator Bentsen for his leadership in proposing a penalty-free withdrawal from Ifs for college tuition in his "Super IRA Plan." In 1986, 87 percent of Americans who used the IRA deduction on their income taxes made $75,000 a year or less. Senator Bentsen's plan would provide middle-income families with an effective and convenient mechanism for college savings. In addition, it would be an invaluable vehicle for meeting current tuition bills by allowing parents to use funds from their existing IRA accounts for college expenses without penalty. An unprecedented component of the "Super IRA" is the incentive provided to grandparents so that they also may contribute toward their grandchildren's college education. The "Super IRA" would also stimulate growth in the personal savings rate among Americans—5.7 percent of disposable income in the first quarter of 1989, down from a post-World War II peak of 9.4 percent in 1973.

Families recognize the importance of sending their children to college. In 1984, the National Institute of Independent Colleges and Universities (NIICU) and the Roper Organization conducted a poll on parents' attitudes toward planning for their children's college educations. The study revealed that more than three of every four parents with children of precollege age expect, or at least hope, that their children will attend college. These hopes must be turned into reality. The gap between the incomes of high school graduates and college graduates continues to grow. For example, the differences between the earnings of men with high school diplomas and college degrees has more than tripled since the early 1970s. (In 1973, a 30 year-old man with a college degree made 16 percent more than his peer with only a high school diploma. By 1986, that gap had grown to 50 percent.)

Parents understand the importance of higher education and saving for college, but they need help in making the savings a reality. In the same Roper poll, we found that two-thirds of the parents see themselves as having the primary responsibility for financing college. But when asked if they are currently saving for their children's higher education, only half of the parents with prospective college entrants said yes. And the average amount saved by parents was only $517 in 1984.

The remaining half who are not currently saving said that they could not afford to do so at this time, but two out of three hoped to save later. Approximately 43 percent of the parents said that they would save more if the Federal Government provided an incentive for education savings.

In addition, the Roper poll showed that half of the general public would save for the education of someone other than their own child if a Federal incentive was available. This broad interest within an extended family in supporting children in their academic pursuits is worth nurturing.

Indeed, students and their families have accepted the responsibility for paying the major portion of expenses at private colleges and universities. NIICU's analysis of U.S. Department of Education data shows that in 1986, 60 percent of all undergraduate expenses at private colleges and universities were paid by students and their families. In addition, even the 65 percent of undergraduates who received financial aid paid one-third or more of their education expenses. And this does not include the loans that they must repay after graduation.

A recent study by the American College Testing (ACT) program explains why more and more parents are asking themselves, "How am I going to afford college for my kids?" The ACT survey found that in the 1987–88 academic year, the average annual cost of a college education—including tuition, books, and room and board ranged from $6,000 at two-year community colleges to $15,400 at private universities. Without financial assistance, the study noted, families need a median income of almost $50,000 to cover a child's expenses at a two-year community college from current income, and a median income of approximately $95,000 for a private university. Comparing these estimates with Census Bureau data on family income, the study reported that only 18 percent of children aged 18 or younger live in families that can afford, out of current income, even the most inexpensive college education at a two-

year public institution. Families simply must have help to save for the education of their children.

To assist parents in answering the question of how they can afford college for their children, private colleges and universities are increasingly devoting a larger proportion of their institutional resources to assist financially needy and academically deserving students. In 1987-88, independent colleges and universities provided $2.3 billion to undergraduates from their own funds, an increase of 489 percent from the $397 million provided in 1970-71. Those schools also provided an additional $1 billion worth of assistance to graduate students that year.

These dramatic increases are a direct response to severe reductions in the availability of Federal aid, particularly grant assistance, to students attending four-year colleges and universities. Pell Grant funds to students attending four-year colleges—public and private combined—have declined by 28 percent in constant dollars since 1979-80. In order to continue their efforts in reaching out to ever-larger numbers of economically disadvantaged students, these institutions made up the shortfall left by the Federal Government and directed more of their own money into financial aid. This, in part, has contributed to an increased in tuitions at private colleges and universities.

This commitment of institutional resources has enabled students from a variety of backgrounds to attend private colleges and universities. Last year, 30 percent of our entering freshmen were the first generation in their families to attend college. Private institutions enrolled twice as many students from families earning less than $30,000 per year than from families earning more than $75,000 per year. In addition, independent colleges and universities have managed to enroll minority students at the same rate as public institutions—17.7 in private colleges and 17.5 percent in public colleges—in spite of our higher tuitions.

Not only has the erosion in Federal assistance contributed to the rising cost of providing a quality education, but a host of other factors are involved. They include: recent tax law changes that have had a chilling effect on charitable giving (fortunately, Senator David Boren, a distinguished member of this committee, has introduced legislation to rectify this problem); skyrocketing employee benefit costs and institutional liability insurance; compliance with new state and Federal regulations; rising faculty salaries; renovation of outdated facilities like classrooms and laboratories; and the purchase of expensive state-of-the-art scientific equipment and computer systems.

Financing college must be nationally recognized as a partnership among parents, students, institutions of higher learning, the private sector, and government on all levels. Savings proposals like the "Super IRA" and the recently adopted Education Savings Act are vital elements of this partnership.

There are many families that cannot afford to save for their children's college expenses. The Federal and state governments must join with colleges themselves in providing financial assistance to these families. The government cannot do it all, however, and families must be encouraged to plan ahead for college expenses. The Education Savings Bond Act, passed by the last Congress, will make a major contribution to this effort, and will particularly help families who can save a small amount over a long period of time through vehicles like their employers payroll deduction plans. The "Super IRA" plan that Senator Bentsen is proposing will fill the large remaining gap, and will also address the dreams and aspirations of parents for their children.

The colleges and universities that we represent will continue to seek private funds for scholarships, and we will continue to help needy students by providing financial aid. But we, and America's middle class, do need your help. With the kind of "Super IRA" Senator Bentsen has proposed, we will finally have the opportunity to work as a true partnership—the Federal Government and the family—to provide the kind of upward mobility and opportunity that many have considered beyond their grasp.

It is a true honor to testify before you today. We sincerely appreciate your leadership and your clear understanding of parents' aspirations for their children.

COMMUNICATIONS

STATEMENT OF RALPH BRASKETT

The Bentsen Super IRA Proposal will encourage more savings in long term investments than the temporary Capital Gains tax reduction in the House bill. Also the flow of savings to the capital markets and revenue to the Federal Government will be more predictable. The Super IRA will do less violence to the IRC as revised by the 1986 TRA—both in 1989 and future years.

The temporary Capital Gains tax reduction will enrich stock brokers (good source of campaign contributions) and further enrich the rich (reward for past campaign contributions). It will not increase long term savings. It may add to the speculative nature of the stock and bond markets, increasing instability. It also will create revenue shortfalls in the "out years" (after the 1990 election of course). The Tree Farmers receive this year's tax benefit—by having ordinary income counted as Capital Gains. who will be the 1990 candidate—the Oil Industry (big source of campaign contributions), the Cattle raisers?? You reinvigorate the useless Tax Shelter industry with this tax reduction. For what purpose?

The IRA proposal will increase savings by the Middle Class. These savings will flow to long term investments and be more predictable in nature. Tax Benefits will flow almost equally to the Middle Class and the Rich—not almost entirely to the Rich.

If you are interested in increasing the flow of investment capital, improving Pension Plan funding, and modestly reducing the instability created by a major player in our investment markets, attached is a proposal sent to my Senators.

You can reach me at 301-434-1540 during business hours, if there are any questions.

October 23, 1989.

LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

ED MIHALSKI,
Minority Chief of Staff,
Washington, DC

Dear Sirs: I am writing in regards to the Bentsen Super IRA proposal. I feel this proposal is a step in the right direction and has my support and many others with whom I have spoken.

However, I feel that married couples where one spouse has a pension plan at work and one spouse does not should be able to deduct the full $2,000 IRA contribution for the spouse who does not have one. In our case, my husband receives no benefits from his company for retirement but I do from a parttime job. We are, therefore, denied the deductibility of my husband's IRA even though my benefit is minimal and he is the main breadwinner. This is unfair.

I strongly urge you to consider this proposal and my comments.

Sincerely,

MARILYN AND LEO EDDINGS,
Alabaster, AL.

STATEMENT OF KLOSE ASSOCIATES NEWTWORK, INC.

I appreciate this opportunity to share with this Committee my thoughts regarding proposals to improve the benefits of the IRA program. These benefits are intended to increase our national savings rate, improve the prospects that our citizens will have a financially secure retirement and permit alternative IRA investments which, as a result of legislative oversight, are not now or yet permitted.

There is strong congressional and consumer interest in improving contribution rules for the IRA. Current interest is supported by a recent survey reported in USA TODAY which revealed that 71% of the customers of a particular brokerage house would increase their participation in IRA savings if funds could be withdrawn tax free for a home purchase or to pay for college. This might suggest that increased IRA savings would result if home purchase or college loan options were added to the program even if there was no improvement in the $2,000 contribution level or Federal income tax deductibility.

Yet the Gramm-Rudman-Hollings constraints must be considered in legislation and I believe that the goal of the proposals of Senator Bentsen can be achieved within these constraints.

WITHIN THE BOUNDS OF REVENUE NEUTRAL CONSIDERATIONS, WE SUGGEST—

First, increasing IRA contribution limits by $2,000 to $4,000 for all taxpayers and keeping the present IRA deduction rules unchanged. This would be revenue neutral and would encourage increased IRA savings.

Second, we believe that IRA funds are appropriate resources to pay for home purchases and to pay for higher education. We would recommend, however, that funds WITHIN the IRA be used for this purpose rather than withdrawing IRA funds for these purposes. Funds withdrawn tax free from an IRA for these purposes are not revenue neutral which would represent a major Federal revenue loss. Withdrawn IRA funds would also affect retirement goals.

Regardless, a first-time or other home purchase is an investment and a higher education loan to a student is an investment. Permitting these investments to be made WITHIN the IRA would accomplish the goal recommended by many and WITHOUT the revenue loss considerations of withdrawing the funds. I also believe that this proposal is revenue neutral.

Under current provisions within the Internal Revenue Code, it is, Senator Bentsen, permitted for your IRA to invest in my home or to lend money to me to pay my daughters college expenses. Under these same rules, however, I cannot invest my IRA funds in my own home or lend money to my daughter for her college expenses. Why not let my IRA make a HOME EQUITY or HOME LOAN INVESTMENT or a HIGHER EDUCATION LOAN INVESTMENT and do this WITHIN my IRA?

This step would use the successful technique of financial organizations which created attractive investment products to encourage IRA savings. In this case, the Federal carrot for increased savings would be permitting two specific IRA investments—home purchase and a higher education loan—and each would enhance the present value of the IRA and WITHOUT a revenue cost to the Federal budget.

The legislative requirement to accomplish the home purchase goals would be to amend Section 408 of the Internal Revenue Code by adding subparagraph (e)(2)(C) to read as follows:

> (C) EXCEPTION FOR HOME EQUITY OR HOME LOAN INVESTMENT—A home equity or home loan investment made by an individual retirement account for the purpose of partially or totally acquiring, constructing or improving a home used as a residence of the person for whom the individual retirement account was established or a residence of any member of the family of that person, shall not constitute a prohibited transaction under subparagraph (A).

Similar language would permit IRA Higher Education Loan investments with the loan represented by a loan agreement held within the IRA as C/Ds, mutual funds, stocks, bonds and other investments are now held within the IRA.

As with other IRA investments such as those listed above, we see no purpose in limiting the dollars an IRA could invest in home investments or in higher education loans.

The legislative language we recommend does not limit IRA Home Investments to a first-time home buyer as there are other individuals who have legitimate, important and responsible needs and who would want to have access to IRA Home Purchase investment funds. Included are persons over age 50-60 who are house-rich and cash-poor yet have a family member with available IRA Home Investment funds

which could buy equity or make a mortgage investment in the home of this cash-poor family member. Yes, Home Equity Conversions for senior housing could be done within IRAs.

And to assure that such new permitted IRA investments are repaid to the IRA when the home is sold or after the education has been provided, we would recommend that the IRA premature distribution rules be applied if the invested funds are not returned to the IRA within an appropriate time-frame.

The above proposals will provide real benefits to the economy and to many people, are revenue neutral, will create important incentives for IRA savings and can be generally accomplished within existing Federal IRA administrative structures.

They will also bring together, for the first time, the two most important elements for the future financial security of our citizens—a retirement plan (the IRA) and the home and add the important IRA investment potential of a college loan.

We cannot conclude this testimony without also endorsing at the next level the proposal to permit withdrawals from an IRA without the Excise Tax (often called a penalty) if the funds are used for a (First-Time) family home investment or for a college education.

This will result in additional Federal revenue as the Federal Income Tax is not forgiven for such a withdrawal. This proposal would also be helpful for those financial institutions not offering a self-directed IRA. Restoring at least a 50% Federal Income Tax deduction (up to $1,000) for IRA contributions made by pension fund participants would be helpful, although costly. And providing a Federal Income Tax Credit of 15% for IRA contributions by those taxpayers with an Adjusted Gross Income below $10,000 would be a significant step toward increasing the national savings rate.

If you have any questions regarding these proposals we would be happy to respond and to work with the Committee if appropriate.

We thank you for this opportunity to provide written testimony on this important National issue.

September 22 1989

Ms Lauri Wilson
Hearing Administrator
Senate Finance Committee SD 203
Washington D C 20510

Dear Ms Wilson,

As a taxpayer I was writing to express my concern regarding Senator Bentsen's Super IRA proposal

First of all I think he idea is great. However, the Catastrophic tax surcharge has alerted that group of taxpayers targeted by this proposal to the dangers of putting money in an IRA to postpone a 28% or 33% tax rate only to see it taxed at 43% or 48% or any other higher rate in existence upon retirement

I believe that to be effective, this proposed Super IRA should include a safeguard against its eventual taxability at a rate higher than the one in existence at the time of contribution

Without this safeguard I as an investment, will not take my chances with Congress and will not contribute to any IRA If many taxpayers feel as I do I doubt if this legislation will achieve its intended purpose of increasing savings

Sincerely
Roger Mezzio
2021 Court Ridge Road
Ranche Palos Verdes CA 90274

MIDWESTERN NATIONAL INSURANCE CORP.,
LaCrosse, WI, October 17, 1989.

LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

Re: Super IRA Proposal

Dear Ms. Wilcox: This is to advise you of my support for the Super IRA Proposal of Senator Bentsen. I do not necessarily oppose the cut in the capital gains tax, but I do think that Senator Bentsen's proposal is just as important if not more important than the cuts in the capital gains tax. The significance of IRA's has steadily declined since Congress took away the IRA tax deduction for employees that were in some type of a qualified retirement plan through his or her employer. Allowing the 50% tax deduction would create many new IRAs and thus make funds available for capital investment in this Country. This will obtain the same type of objectives as a cut in the capital gains tax and will encourage retirement savings by employees at the same time.

Senator Bentsen's plan to allow early withdrawals from IRA accounts without penalties when the funds are used for educational purposes or for down payment expenditures for first time home buyers is even more important than the 50% deduction. At the present time, the Federal Government does little to assist middle income taxpayers with higher education expenses. If such taxpayers are forced to use their IRA funds to pay for their children's higher education expenses, the Federal Government should not increase such taxpayers burden by imposing an additional 10% tax penalty on such funds. The same arguments can be made for first time home buyers. With the shortage of housing and the number of homeless persons in this Country, the government should not add tax penalties for persons who must sacrifice IRA retirement savings for a first time home purchase.

Sincerely,

MICHAEL D. ENGEL, *Vice President,*
Secretary, General Counsel.

STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS

INTRODUCTION

The NATIONAL ASSOCIATION OF REALTORS appreciates this opportunity to express its support for a proposal made by Senator Bentsen to reinstate deductions for Individual Retirement Accounts (IRA) and to eliminate penalties on withdrawals from IRAs that are used as a downpayment on the first-time purchase of a home. We also appreciate the opportunity to suggest improvements to the proposal.

The NATIONAL ASSOCIATION OF REALTORS (NAR) has more than 800,000 members, who represent virtually every facet of the real estate industry, including REALTORS sales agents, developers, appraisers, syndicators, and property managers. The NATIONAL ASSOCIATION OF REALTORS generally supports proposals that increase homeownership opportunities, particularly for those discouraged from the market by high interest rates and high downpayment requirements. Accordingly, NAR commends Sen. Bentsen for taking this important step towards solving the problem of housing affordability that face our country.

THE PROBLEM OF HOUSING AFFORDABILITY IN AMERICA

Since World War II, more and more Americans have chosen to own their homes. Recently, however, the homeownership rate (the percentage of Americans owning their homes) has trended downward. The homeownership rate slowly but steadily declined between 1980 and 1988, after having climbed consistently since the end of World War II. This is the first sustained decline since the Great Depression. Table 1 shows the percentages of homeownership by decade by 1930, and for each year of this decade of the 1980s, as well.

Most disturbing is the declining homeownership rate in certain segments of the population. Between 1980 and 1988, the incidence of homeownership declined in all age groups in the population. The largest decreases were exhibited by those under 25 years old and those in the prime homebuying ages of 25 to 34. The combined homeownership of these two age groups shrank by about 15 percent during this

eight-year period. Table 2 describes the homeowning population by age and income, and reflects the decline in homeownership among all groups.

Individuals and families today face difficult challenges in accumulating sufficient funds for a first-time downpayment. Between 1973 and 1980, house prices rose 115 percent nationally, while median family incomes rose only 75 percent. Over that same timespan, median incomes of first-time homebuyers rose by only 52.3 percent. This lag between incomes and housing prices exacerbates an already difficult problem for individuals attempting to amass a downpayment.

The NATIONAL ASSOCIATION OF REALTORS compiles a first-time homebuyer affordability index, based on a 10 percent downpayment on a median-priced starter home. It shows that while the plight of first-time homebuyers has improved somewhat since 1982, first-time homebuyers' incomes are still about 20 percent less than what is currently needed to purchase a starter home and support a mortgage. Accordingly, a new source of capital is crucial for these individuals so they can increase their equity stake and support mortgages.

INDIVIDUAL RETIREMENT ACCOUNT

A vast pool of capital currently exists in the funds invested in IRAs. Making this capital available to contribute toward a downpayment on a house is a significant step toward addressing our national problems of housing affordability.

The pool of available IRA capital is indeed substantial. Total contributions to IRAs grew from $5 billion in 1981 to an estimated $45 billion in 1986. Existing IRAs currently represent more than $200 billion in savings. This enormous accumulation comes largely from individuals of comparatively modest means. According to the National Bureau of Economic Research, in the period 1983–1984, over 70 percent of the individuals contributing to IRAs had incomes below $50,000, and 52 percent had incomes below $40,000. This data suggests that the benefits of IRAs do not inure principally to the wealthy, but that they are an important savings tool for a large portion of working Americans. As illustrated in Table 2, however, it is individuals in these same income classes who are experiencing steep declines in homeownership. Indeed, it is possible to conclude that amassing sufficient funds to contribute to an IRA is a much less daunting task than amassing the many thousands of dollars needed in today's market to purchase even a starter home.

Use of an individual's IRA for making a downpayment on a first-time purchase of a home has been recognized for several years as an important facet of housing policy. The 198— so-called Rouse/Maxwell report on housing affordability recommended the use of IRAs for this purpose. Careful scrutiny of the problem at hand, however, suggests that there is one glaring defect in both the Rouse/Maxwell proposal and the Chairman's proposal. The Chairman's proposal would permit taxpayers to make penalty-free withdrawals from their IRAs for the first-time purchase of a home, or for the payment of education expenses. In the case of education expenses, the Chairman's proposal acknowledges the fact that young people of typical college age have not begun accumulating IRAs. Accordingly, the Chairman's proposal would permit not only a parent's IRA to be used for education expenses, but a grandparent's IRA as well.

USE OF PARENT'S AND GRANDPARENT'S IRAS

The NATIONAL ASSOCIATION OF REALTORS believes that individuals in the primary household formation group, from ages 25 to 34, who are experiencing a rapidly declining rate of homeownership, will not, typically, have large IRAs, if they have any IRAs at all. Accordingly, the NATIONAL ASSOCIATION OF REALTORS recommends that the Chairman's proposal for the use of IRA funds for housing be made symmetrical with the proposals on the use of funds for education. Therefore, we recommend that IRA funds of a parent or a grandparent can be used to assist a child or a grandchild in the first-time purchase of a home.

Senator Bentsen's proposal does establish an important precedent in addressing crucial housing affordability problems. The proposal can be improved, however, by permitting family wealth to be used for intra-family purposes. Use of family wealth for the benefit of other family members is acknowledged elsewhere in the Internal Revenue Code.

Section 213 permits individuals to deduct allowable medical expenses not only for themselves, but also for their children and dependents as well. During 1987, following the Tax Reform Act of 1986, mortgage interest deductions were permitted when the taxpayer used mortgage proceeds for medical or education expenses for family members. The entire scheme of Section 152 personal exemptions contemplates that some family wealth should be excluded from taxation as contributing to the support

of the family. In addition, tax credits are permitted for the care of children and other dependent family members. Therefore, the NATIONAL ASSOCIATION OF REALTORS believes that use of family funds to benefit family members is not inconsistent with current tax policy. This is especially true if the withdrawn IRA funds will be subject to the income tax. A parental contribution to a child's downpayment would, in effect, be made with after-tax dollars, and should, therefore, be viewed as a legitimate use of family wealth.

The use of a parent's or a grandparent's IRA is consistent with the use of IRA funds to defray education expenses. Senator Bentsen's proposal contemplates that a parent's or grandparent's IRA funds could be withdrawn penalty-free to support a child's or grandchild's education. There is no policy justification for barring the use of the parent's or grandparent's funds for a downpayment on the first-time purchase of a child's or grandchild's home. The education and housing provisions of the proposal should be symmetrical.

Finally, Senator Bentsen's proposal, while making an important symbolic gesture, does not give recognition to the practical reality that young people, if they have IRAs, will not have accumulated substantial funds. Owners of IRAs tend to be in age groups older than the household formation age group. For example, the Investment Company Institute, which represents the mutual fund industry, has compiled a demographic profile of the typical shareholder who holds an IRA through a mutual fund. In 1988, this individual was 50 years old, married, and owned a home. Thus, it can be concluded that the typical IRA owner is well beyond the household formation and first-time home purchase phases of a life cycle. Accordingly, if Senator Bentsen's proposal is to be part of a meaningful solution to the housing affordability problem, parental IRAs should be made available to contribute toward the housing costs of younger family members with minimal accumulation of savings.

Table 1.—U.S. HOMEOWNERSHIP RATE

[Percentages]

Previous Decades		The 1980s	
Year	Percent	Year	Percent
1930	47.8	1980	65.6
1940	43.6	1981	65.4
1950	55.0	1982	64.8
1960	64.2	1983	64.6
1970	64.6	1984	64.5
1980	65.6	1985	63.9
		1986	63.8
		1987	64.0
		1988	63.8

Source: U.S. Bureau of the Census

Table 2.—HOMEOWNERSHIP RATE BY SELECTED HOUSEHOLD CHARACTERISTICS: 1980–1988

[Percentage Distributions]

	1980	1983	1988	Percent change 1980–1988
All Households	65.6	64.6	63.8	-2.7
Age:				
Under 25	21.3	19.3	15.5	-27.2
25–34	52.3	47.0	45.0	14.0
35–44	72.3	69.6	67.1	-7.2
45–64	78.5	78.8	77.8	-1.0
65 and over	72.3	74.8	75.0	-3.7
Income:				
Under $5000	49.4	43.3	39.5	-20.0
$5000–$9999	56.8	50.3	48.6	14.4
$10,000–$14,999	59.1	55.8	52.7	13.9
$15,000–$19,999	66.5	59.7	57.6	13.4
$20,000–$24,999	73.7	65.7	61.4	16.7
$25,000–$34,999	82.0	74.1	68.0	17.0

Table 2.—HOMEOWNERSHIP RATE BY SELECTED HOUSEHOLD CHARACTERISTICS: 1980–1988—Continued

[Percentage Distributions]

	1980	1983	1988	Percent change 1980–1988
$35,000-$49,999	88.5	81.6	77.6	−12.3
$50,000+	91.9	89.1	86.9	−5.4

Sources:
"All Households" data from U.S. Bureau of the Census, Current Housing Reports, Series H-111, Vacancy Rates and Characteristics of Housing in the United States, Nos. 76-5 through 86-5.
Age data from American Housing Survey, 1980; U.S. Dept. of Commerce, Current Population Survey, 1983 and 1988
Income data from U.S. Bureau of the Census, Current Population Reports, Series P-60.
Tabulations by the Economics and Research Division, NATIONAL ASSOCIATION OF REALTORS.

NEW YORK LIFE INSURANCE CO.,
New York, NY, October 18, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Senate Dirkson Office Building,
Washington, DC

Mr. EDMOND J. MIHALSKI,
Minority Chief of Staff,
Senate Dirkson Office Building,
Washington, DC

RE: Senator Lloyd Benson's Super IRA Proposal

It would be great to have a bill that benefits all Americans, not just those with higher incomes. The current IRA restrictions are hurting millions of Americans' ability to provide for their retirement security.

I support this bill 100%. This bill will help *more Americans* than a Capital Gains Tax bill. We need a bill that encourages retirement and savings more than investment for capital gains. I also applaud the bill's special provision for penalty free withdrawals for college and first time homes, and removal of the current IRA restrictions based on income of those who are already covered by a plan. EVERYONE SHOULD BE ABLE TO HAVE A TAX DEDUCTIBLE IRA IF THEY HAVE EARNED INCOME.

I also urge the Senate to follow the House's lead in totally repealing Section 89 and urge you to pass additional bills that will simplify existing laws, reduce the reporting and compliance burden, and encourage small employers to provide pension and health plans for the employees via similar tax credits, etc.

Sincerely,

CARL L. LEWALLEN, *Agent.*

OMNI INSURANCE CO.,
Atlanta, GA, October 16, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

RE: Senator Benson's Super IRA Proposal

Dear Ms. Wilcox: It would be great to have a bill that benefits all Americans, not just those with higher incomes. The current IRA restrictions are hurting millions of Americans' abilities to provide for their retirement security.

We support this bill 100%. This bill will help many *more Americans* than a Capital Gains Tax bill. We need a bill that encourages retirement and savings more than investment for capital gains. We also applaud the bill's special provision for penalty free withdrawals for college and first time homes, and removal of the cur-

rent IRA restrictions based on income of those who are already covered by a plan. EVERYONE SHOULD BE ABLE TO HAVE AN IRA IF THEY HAVE EARNED INCOME.

We also urge the Senate to follow the House's lead in totally repealing Section 89 and urge you to pass additional bills that will simplify existing laws, reduce the reporting and compliance burden and encourage small employers to provide pension and health plans for their employees via similar tax credits, etc.

Sincerely,

RENEE WEESE, *Vice President, Human Resources.*

PERSONALIZED BUSINESS CONSULTANTS, INC.,
Woodstock, GA, October 12, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

ED MIHALSKI,
Minority Chief of Staff,
Washington, DC

RE: Senator Bentsen's Super IRA Proposal

It would be great to have a bill that benefits all Americans, not just those with higher incomes. The current IRA restrictions are hurting millions of American's ability to provide for their retirement security.

We support this bill 100%. This bill will help many *more Americans* than a Capital Gains Tax bill. We need a bill that encourages retirement and savings more than investment for capital gains. We also applaud the bill's special provision for penalty free withdrawals for college and first time homes, and removal of the current IRA restrictions based of income of those who are already covered by a Plan. EVERYONE SHOULD BE ABLE TO HAVE AN IRA IF THEY HAVE EARNED INCOME.

We also urge the Senate to follow the House's lead in totally repealing Section 89 and urge you to pass additional bills that will simplify existing laws, reduce the reporting and compliance burden and encourage small employers to provide pension and health plans for their employees via similar tax credits, etc.

LAWRENCE D. AABERG-SNEATH.
GLORIA L. AABERG-SNEATH.

PERSPECTIVES,
Lexington, KY, October 17, 1989.

MS. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

Re: Senator Bentsen's Super IRA Proposal

It would be great to have a bill that benefits all Americans, not just those with higher incomes. The current IRA restrictions are hurting millions of American's ability to provide for their retirement security.

We support this bill 100%. This bill will help many more Americans than a Capital Gains Tax bill. We need a bill that encourages retirement planning and savings over investment for capital gains. We also applaud the bill's special provisions for penalty-free withdrawals for college and first time homes, and removal of the current IRA restrictions based on income of those who are already covered by a Plan. EVERYONE SHOULD BE ABLE TO HAVE AN IRA IF THEY HAVE EARNED INCOME.

We also urge the Senate to follow the House's lead in totally repealing Section 89 and urge you to pass additional bills that will simplify existing laws, reduce the re-

porting and compliance burden, and encourage small employers to provide pension and health plans for their employees via similar tax credits.

Sencerely,

PHILIP A. WYANT, *President.*

RETIREMENT INDUSTRY TRUST ASSOCIATION,
Denver, CO, October 18, 1989.

LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

Re: Comments on S. 1682

Dear Ms. Wilcox: The Retirement Industry Trust Association ("RITA") is a national non-profit organization of corporate trustees that maintain assets in excess of nine billion dollars for over one million individuals in all 50 states. RITA was organized in 1986 as a national trade association for trustees of self-directed, tax-exempt retirement plans, with a concentration in Individual Retirement Accounts ("IRAs"). RITA's governing purpose is to promote the efficient administration of retirement plans throughout the financial services industry. Its goal is achieved to a great extent through legislative and regulatory activities. Accordingly, on behalf of the member companies of RITA, we hereby respectfully submit the following comments on Senate Finance Committee Chairman Lloyd Bentsen's "Super IRA" proposal (S. 1682).

As numerous studies have shown, IRAs have been found to have a positive impact on the United States savings rate. The members of RITA have found that the level of contributions to IRAs have been reduced as a result of the changes in the law under the Tax Reform Act of 1986. RITA thereby supports the Bill as a means to increase the United States personal savings rate to an acceptable level.

The members of RITA also support the Bill as a means to help restore equity to private retirement savings that was adversely affected by the Tax Reform Act of 1986. Specifically, it is our opinion that the active participant rules have, in many cases, reduced the level of contributions for individuals who are classified as "active participants" for purposes of this rule, but who, in actuality, have not been provided with retirement savings. For example, a nonvested participant with Adjusted Gross Income in excess of the stated levels who terminates employment will lose his benefit with his employer; however, he has been precluded from depositing deductible IRA contributions for years in which he was considered an "active-participant" under the plan. In addition, the spouse of the participant was also precluded from depositing deductible contributions, even if he/she was not covered by a retirement plan at work. Furthermore, an individual who is fortunate to have a salary reduction plan at work is able to deposit up to $7,000 (as adjusted annually) for retirement savings, where an individual whose employer has not established such a plan (but is perhaps a nonvested participant or a spouse of an active participant) would not be eligible to deposit similar amounts to a retirement plan at work or in an IRA (deductible or nondeductible).

The members of RITA also question why IRA contributions and Adjusted Gross Income levels are not indexed to inflation. Salary reduction contributions have increased from $7000 to $7627 since the passage of the Tax Reform Act of 1986. In addition, contributions to qualified business retirement plans under Internal Revenue Code Section 415 may be increased in the future. Contributions to IRAs, however, will remain a constant $2000 under current rules. In addition, there is no provision under the current rules to increase the Adjusted Gross Income levels which affect the deductibility of IRA contributions.

We appreciate the opportunity the Senate Finance Committee has given us to comment on this proposal. The members of RITA would also like to take this opportunity to notify the members of the Senate Finance Committee that we would be available to meet with them at anytime to discuss the current proposal, as well as any future proposals affecting the retirement plan industry. Our members have access to information and experience that will be of great benefit to the Committee in their endeavors in this area. I can be reached at the address on the letterhead or

my telephone number is (800) 258-7878 or (312) 571-3343. Thank you for your consideration.

Sincerely,

ELIZABETH S. SMITH, *President.*

DAVID A. SCOTT, CPA,
Memphis, TN, October 17, 1989.

Ms. LAURA WILCOX,
Hearing Administrator,
Senate Finance Committee,
Washington, DC

RE: Senator Bentsen's Super IRA Proposal

Dear Ms. Wilcox: It would be great to have a bill to benefit all Americans, not just those with higher incomes. The current IRA restrictions are hurting millions of American's ability to provide their retirement security.

I support this bill 100%. This bill will help many more Americans than a capital gains tax bill. We need a bill encouraging retirement and savings more that investment for capital gains. I also applaud the bill's special provisions for penalty free withdrawals for college and first time homes, and removement of the current IRA restrictions based on income of those who are already covered by a plan. Everyone should be able to have an IRA if they have earned income.

I also urge the Senate to follow the House's lead in totally repealing section 89 and urge you to pass additional bills that will simplify existing laws, reduce the reporting and compliance burden and encourage small employers to provide pension and health care plans for their employees via similar tax credits, etc.

Sincerely,

DAVID A. SCOTT, CPA.

28-509 (100)